Taxing Simply

District of Columbia Tax Revision Commission

Taxing Fairly

Full Report

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CHAPTER I

The District of Columbia's Individual Income Tax

Structure, Characteristics, and Policy Alternatives

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Structure of paper

This paper seeks to address four broad questions related to the District's personal income tax:

- What are the major structural characteristics of the District's personal income tax and those of its neighbors, and what are their empirical characteristics?
- What has been happening to the population base on which personal taxes are levied, and for whom are services provided? Can one ascribe the District's declining population to adverse tax policies or are other factors at work?
- Given the current status of the District's personal income tax, what policy options are available, especially to achieve the goals of revenue adequacy and administrability? What are the implications of various types of conformity to the federal individual income tax?
- What might be the dimensionality of a commuter tax in terms of base and rate?

To address these questions, the chapter is organized as follows: The beginning sections give an overview of state and local income taxes and their role in central city finances as well as a history of the District's personal income tax. These sections are followed by: 1) an examination of the major components of the District's personal income tax in terms of structural and empirical characteristics, and 2) a comparison of the District and its tax burdens to those of Maryland and Virginia.

The next several sections discuss the issue of in- and out-migration of District taxpayers by examining:

- resident population and income of residents and nonresidents over the period 1969–1995 as measured by the Bureau of Economic Analysis;
- aggregate migration into and out of the District based on federal tax returns;
- migration into and out of the District through analysis of 1989 and 1995 District tax returns; and

- the effect of changes in the District's crime level on movements of taxpayers by zip code.

The final sections examine policy options for the District's personal income tax by discussing:

- policy options that would enhance the revenue productivity and ease of administration of the District's individual income tax through simplification and greater conformity with the Internal Revenue Code; and
- arguments for and against taxing commuters, empirical aspects of commuter taxes, and possible rates, revenues, and administrative issues associated with a commuter tax.

Unless otherwise noted, all tables and graphs reflect the author's calculations based on tax return data.

State personal income taxes

State taxation of personal income dates back to America's colonial period, when property and income taxes were combined in the form of "faculty taxes." Pennsylvania levied a 1 percent tax on salaries in 1840, and income taxes were prominent in the North and South to finance the costs of the Civil War.[1]

The first modern state personal income tax was adopted by Hawaii in 1901. Wisconsin became the first continental state to adopt a personal income tax in 1911; it had a top marginal tax rate of 6 percent. By the close of that decade, eight other states had adopted personal income taxes, and another six did so the following decade.[2] The Depression witnessed an additional 16 states adopting a personal income tax.[3] The District adopted its income tax in 1947, and Alaska adopted its in 1949. From 1961 through the mid-1970s, 11 additional states added personal income taxes.[4]

Local income taxation and central city finance

The long-run decline in central city populations, especially older industrial cities, has been well chronicled by demographers through analyses of census data. Of the 218 cities with populations over 100,000 in 1994, 67 lost population over the last quarter century. While these cities overall accounted for 33.1 million of the 1970 population of 203.3 million (16 percent), they accounted for only 27.4 million of the 1994 pop-

Figure I-1

Large Cities Losing Population 1970–1994
by Size of 1970 Population (in thousands)

City	1970 Population	1994 Population	Population Loss	Percent Population Loss
New York, N.Y.	7,896	7,333	-563	-7%
Chicago, Ill.	3,369	2,732	-637	-19
Philadelphia, Pa.	1,949	1,524	-425	-22
Detroit, Mich.	1,514	992	-522	-35
Baltimore, Md.	905	703	-202	-22
Washington, D.C.	757	567	-190	-25
Cleveland, Ohio	751	503	-248	-33
Milwaukee, Wis.	717	617	-100	-14
Boston, Mass.	641	548	-93	-15

Source: U.S. Census Bureau.

ulation of 258.1 million (10.6 percent). The 5.3 million residents lost between 1970 and 1994 amounted to 15.9 percent of these cities' total 1970 population.

As Figure I-1 shows, many of these cities lost more than 20 percent of their 1970 population. Some lost very large numbers between 1970 and 1994: New York, Chicago, Philadelphia, and Detroit each lost more than 500,000 residents during this period.

The District is among 15 major cities that lost more than 15 percent of their population between 1970 and 1994. Not only have its finances been headline news over the past several years, but its population loss, decline in public services, and crime have been especially troubling for all elected federal officials.

The assertion that central city population loss has been especially heavy for middle- and upper-income households can be found throughout much of the demographic and urban literature on central city decline. Attracting middle- and upper-income residents and retaining residents is often argued to be a crucial ingredient to rebuilding the tax base and civic life of these cities.[5]

History and importance of the District's personal income tax

The District's individual income tax dates back to 1939, although the broad-based version was adopted in 1947. It has amounted to about 25 percent of the District's

Figure I-2

Individual Income Taxes as Percent of Personal Income

	1975 Tax Burden	1993 Tax Burden
District of Columbia	2.9%	3.8%
Maryland	4.1	4.1
Virginia	2.9	2.7
Average, U.S.	**1.9**	**2.4**

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

annual own-source tax collections over the past decade. With regard to the District's neighboring states, Virginia's state and local governments relied on the individual income tax for 26 percent of the state's tax revenues, while Maryland's state and local income taxes accounted for 38 percent of total Maryland state and local taxes.[6] Nationally, state and local governments relied on the individual income tax for one out of every five tax dollars raised.[7] Thus, the District is above-average in its reliance on the personal income tax to finance services to District residents, but in the region relies less than its major competitor (Maryland). Figure I-2 compares 1993–1994 personal income tax burdens to those in 1975. While the District's burden rose, it was primarily due to personal income rising more slowly than taxes. The District's 1993 personal income tax collections were 4.5 times that of 1975, but its personal income in 1993 was only 3.4 times that of 1975. In Maryland, personal income tax collections in 1993 were about 4.9 times that of 1975.[8]

In 1989, 310,000 District individual income taxpayers had a personal income tax liability of $534.9 million, while in 1995, 251,000 taxpayers had a net personal income tax liability of $556 million. The District's decline in resident population and decline in resident tax paying population and the resulting sluggish growth in revenues will be a constant focus of the research reported below.

Public finance principles and personal income taxation

State and local governments have generally been enabled to employ a broad arsenal of revenue instruments to finance state and local services. The U.S. Constitution imposes few impediments to their use of property, sales, gross receipts, excise, franchise, and income taxes. Tax systems have multiple and sometimes conflicting objectives to:

- finance the budget for needed public services;
- achieve agreed-upon equity objectives;
- interfere as little as possible with private household and business choices through the imposition of taxes; and
- apply taxes in a certain and transparent fashion so that frequent rate changes are not needed, and compliance and administration are inexpensive.

Therefore, the question arises as to how a small geographic area such as the District should employ a tax as visible as a personal income tax.

When raising public revenues to finance public services, there is merit in determining at the outset if the service is general or narrow in impact. If the latter is true, then a case can be made for supporting its budgetary cost through benefit-related taxes or even fees. At the local level, resident use of police and fire services may be measured by the value each resident derives from the protection of his or her real estate. A local property tax applied at a proportional rate can be viewed as a benefit tax. Other services, such as public education or health, are provided to achieve distributional objectives. Here, one typically favors financing such activities through ability-to-pay taxes such as income or broad-based consumption taxes. When the geographic area of a government is small, one typically expects a government which covers a larger geographic area to assist in financing income redistribution activities. Otherwise, one asks poor areas of a state to finance their contributions to income maintenance and the provision of services which are income redistribution in kind. As the District has no higher level of government other than the federal government to look for assistance in financing services, there is likely to be a constant tension between the service needs of the community, and the willingness of its residents to finance it.[9]

Unlike most states, the finances of the District are impacted by two other important phenomena:

- The presence of significant federal, tax-exempt property makes relying on local benefit taxation to finance property-related services (e.g., fire, police, housing inspection, zoning, etc.) more difficult.
- The presence of large numbers of commuters who use significant amounts of municipal (but not education) services. While 724,412 individuals worked in the District in 1990, only 236,734 were both District residents and worked in the District.[10] Another 67,694 District residents worked outside the District in 1990. The ratio of nonresident workers to resident workers was 2:1 in 1990 and was among the highest of any major city in the United States. Almost half a million people commuted into the District in 1990 to work.

While the District is not enabled, as a condition of its *Home Rule Act of 1971*, to impose a personal income tax on commuters, the renegotiation of the federal payment and reshuffling of financing and service responsibilities which occurred in 1997 make the analysis of a commuter tax of some interest to those seeking to reform the District's tax system.

Structural features of the District's individual income tax

The District of Columbia is one of 37 states to impose an individual income tax based initially on an income concept derived from the Internal Revenue Code (IRC), which governs the federal income tax. Of the states with an individual income tax, only five are uncoupled from the IRC.[11] The District individual income tax follows 25 others in beginning its definition of income subject to tax by reference to federal Adjusted Gross Income (AGI). Five states begin with federal taxable income, and three (North Dakota, Rhode Island, and Vermont) base their individual income tax on federal liability.[12]

Over the last 30 years, changes in tax rates and brackets have been enacted. In 1965, the top marginal tax rate was 5 percent of taxable income in excess of $25,000; this was increased to 11 percent in 1976. The top marginal rate was lowered to 10 percent for tax year 1987, and 9.5 percent for tax year 1988. In 1970, the District conformed its taxation of capital gains to the federal definition, and in 1975, conformed personal exemption and child care deductions.[13] Since 1988, the tax rate has been 6 percent for taxable incomes under $10,000, 8 percent for taxable incomes of $10,000–$20,000, and 9.5 percent for taxable incomes in excess of $20,000 of taxable income.

Over time the value of the personal exemption has been increased: $885 for tax year 1987, $1,025 for tax year 1988, $1,160 for tax year 1989, $1,270 for tax year 1990, and $1,370 for tax year 1991 to the present.[14]

DETERMINING PLACE OF RESIDENCE

A key element of the taxation of household income is the determination of whether or not the income is subject to a jurisdiction's authority to tax, and whether or not taxes imposed at the place of work are recognized, through credit or deduction, at the place of residence. Given the generally high level of mobility of individuals and households, the determination of residence has significant implications for both revenue and administration of the District's personal income tax.[15]

Four concepts of "resident" may be found among state personal income taxes:

- domiciled in the state
- presence in the state for other than a temporary or transitory purpose

- presence in the state for a specified period of time, measured in months or days
- maintenance of a permanent place of abode in the state[16]

Evidence of being domiciled often includes registering a motor vehicle in the state, maintaining bank accounts in the state, obtaining a driver's license in the state, and voting in the state.

The District taxes a resident's income, but cannot, under *Paul S. Davis v. District of Columbia,* tax income earned outside of the District of an individual prior to his or her becoming a resident. For the District's personal income tax purposes, a resident is defined as one who either:

- is domiciled at any time in the District during the taxable year; or
- maintains a place of abode within the District for an aggregate of 183 days or more. Temporary absences from a D.C. residence for vacations, hospitalization, or business trips are deemed to be periods of D.C. residency under case law.

The District also taxes nonresidents' income earned in the District from unincorporated business sources at a rate of 9.5 percent plus a surcharge of 2.5 percent for an effective rate of 9.975 percent, the same as the corporate tax rate, less a $5,000 exemption. Nonresident personal service income, where capital is not a material income-producing factor, is exempted from the nonresident tax.[17] Thus, nonresident income earned by the legal profession is exempt, but partnership income earned from the rental of apartment buildings owned by nonresident partners is taxable.

The District individual income tax form instructions add an obligation to file a return if:

- "Your permanent residence was in the District for part of or the full taxable year";
- "You lived in the District for 183 days or more during the taxable year, even though your permanent residence was outside the District";
- "You were a member of the armed forces and your home of record was the District for part of or the full taxable year";
- "You are a spouse of an exempt military person or of any other exempt person such as a nonresident presidential appointee."

Members of Congress who maintain a place of abode in the District in relation to their attending sessions are not taxable, nor are such officials as Supreme Court justices. In addition, foreign embassy personnel are generally exempt from District individual income taxation.

Disputes over District residency rules have been prominent for a long period of time, and there is significant case law dealing with the precise nature of having a

District domicile in comparison to that of another state of residence, the determination of intent to return to another place of domicile, and the domiciliary treatment of Foreign Service officers and others appointed by the president to positions in the executive branch of government.

Disputes have arisen in Maryland and Virginia over whether their tax statutes allow their residents to take credits for District taxes paid against their Maryland and Virginia resident income tax liability. While the Maryland statute permits residents a credit for "income tax" paid to "another State upon such part of his net income," the Maryland Supreme Court in 1957 denied a credit paid for the District's tax on unincorporated business because the tax was determined by the court to be a privilege tax rather than an income tax. The Virginia Supreme Court reached the opposite conclusion about the nature of the unincorporated business income tax, and allowed its residents a credit against the Virginia individual income tax on the same set of facts in 1990.[18]

Recently, the Virginia tax department's denial of a Virginia resident's claim for a credit for the District's nonresident income tax on unincorporated business income paid was upheld, because the District's nonresident income tax was found by the Virginia Supreme Court to be a commuter tax in violation of the *District of Columbia Home Rule Act*.[19] Virginia currently provides a credit only for other states' taxes which are legal and authorized under other states' laws.

FILING STATUS

The District's personal income tax recognizes five major filing categories.

- **Single** — unmarried individuals living alone, or married individuals who are not living with their spouse on the last day of the year.
- **Head of Household** — follows the federal definition in the Internal Revenue Code, e.g., an unmarried individual with a son, daughter, descendent of either, or stepchild.
- **Married Filing Jointly** — for District tax purposes, couples must file a Married Filing Jointly return or a Married Filing Combined Separate return if they are required to file federally as Married Filing Jointly to get federal tax benefits (i.e., the federal earned income tax credit).
- **Married Filing Separately** — married persons if the gross income of each exceeds the sum of his/her personal exemptions.
- **Married Filing Combined Separate** — allows each spouse to be treated in effect as a single taxpayer with dependents. They agree to share the number of dependents and deductions in a mutually agreeable manner, and file on one return, filling in Column A and Column B of D.C. Tax Form D-40. There is no federal counterpart to this. Note that Maryland (but not Virginia) accords married taxpayers this filing alternative.

TRENDS IN NUMBERS OF DISTRICT TAX FILERS

The number of District individual income tax filers has dropped over time. Figure I-3 displays the number of individual income tax filers by AGI class and type of filing unit for 1989 and 1995. Note that the AGI classification is based on the *sum* of each person's federal adjusted gross income shown on Line 1 of the D-40 and is as close an approximation to household economic income as is possible.

Several things are immediately evident from an inspection of this table. First, the number of tax returns dropped overall by 20 percent during this six-year period.[20] Second, the fall occurred in returns with AGI of less than $45,000; there was some growth in the highest brackets overall. Note that the number of taxpayers in the $100,000–$500,000 income class grew by 30 percent. Second, while there was modest overall growth in the number of tax filers in the AGI classes above $45,000, this was not the case for Married Filing Combined Separate; their numbers dropped in all brackets except the $100,000–$500,000 AGI class. Overall, this group of taxpayers showed the largest percentage reduction overall among all filers, falling by 31 percent.

The results for 1995 of matching District taxpayers to their federal tax returns are as follows: Overall, there were 246,399 returns which could be matched by social security number.[21] There were 46,190 District tax filers who did not file federal tax returns; this likely reflects the fact that the income level at which District income tax is owed is well below the federal level. Thus, 29,432 single taxpayers filed for District tax purposes but not for federal tax purposes.

The relationship between District and federal filing status is generally quite strong. The largest exception is among those who file Married Filing Jointly for federal purposes. Of the 34,995 District filers in this category, 18,310 filed District returns in the same status and 15,921 filed Married Filing Combined Separate.

Figure I-4 displays the amount of District tax paid by different filing units in 1995 scaled in thousands of dollars. Single taxpayers were the largest filing group in 1995: Overall they paid $246.4 million out of the $556 million in 1995 District tax liability shown on District returns. This was 44 percent of total tax liability although singles were 54.9 percent of total 1995 District tax filers.

The next largest group in terms of tax liability in 1995 was Married Filing Combined Separate; these filers had $149.2 million in 1995 liability or 26.8 percent of the total; however, such taxpayers numbered only 19,693 or 8 percent of total District tax return filers. Also, note that $32 million of District Married Filing Combined Separate liability was attributable to those for whom no federal returns could be matched.

The third most important filing status in terms of tax liability was Married Filing Jointly; their tax liability was 15.1 percent of the total, while they constituted 7.7 percent of tax returns filed for District tax purposes. The Head of Household

Figure I-3

D.C. Tax Filers in 1989 and 1995

	Single		Head of Household		Married		Married Filing Separately		Married Filing Combined Separate	
AGI Class	**1989**	**1995**	**1989**	**1995**	**1989**	**1995**	**1989**	**1995**	**1989**	**1995**
$0–1,500	6,611	8,389	708	983	414	586	160	248	274	476
1,500–5,000	18,786	7,587	3,535	2,670	577	419	410	319	21	23
5,000–10,000	24,547	13,614	8,522	6,495	1,899	1,068	857	529	67	54
10,000–15,000	22,946	14,408	11,777	9,031	3,005	1,861	1,266	671	307	108
15,000–20,000	23,244	14,140	13,279	9,242	3,146	2,218	1,437	833	686	239
20,000–25,000	19,866	14,088	10,071	8,294	2,567	2,055	1,355	916	1,050	423
25,000–35,000	25,493	22,640	9,722	9,871	3,912	2,903	1,575	1,540	2,892	1,183
35,000–45,000	13,760	13,779	3,679	4,836	2,916	2,128	954	930	3,665	1,623
45,000–55,000	7,244	8,685	1,226	2,185	2,024	1,716	505	572	3,631	1,727
55,000–65,000	4,160	5,360	534	950	1,508	1,452	282	366	3,114	1,771
65,000–75,000	2,622	3,706	275	431	1,131	1,170	180	248	2,432	1,624
75,000–100,000	2,965	4,673	291	431	1,720	2,097	259	371	3,908	3,111
100,000–500,000	2,645	3,999	262	396	2,342	3,580	280	436	6,107	6,766
500,000+	188	163	25	18	193	249	31	42	463	565
Total	175,077	135,231	63,906	55,833	27,354	23,502	9,551	8,021	28,617	19,693

Source: Author's calculations based on D.C. tax data files.

Figure I-4

1995 D.C. Tax Liability
by Federal and D.C. Filing Status ($ thousands)

	Federal Filing Status							
D.C. Filing Status	**Single**	**Married Filing Jointly**	**Married Filing Separately**	**Head of Household**	**Widow(er)**	**Married Filing Separately/ Other**	**No Return Filed**	**Total**
Single	$203,088	$216	$211	$1,847	$28	$5	$41,013	$246,408
Head of Household	736	202	36	46,829	230	4	7,169	55,206
Married Filing Jointly	15	63,183	65	61	23	11	20,568	83,926
Married Filing Separately	84	1,352	9,035	35	0	71	7,612	18,189
Married Filing Combined Separate	74	115,843	898	18	0	0	32,333	149,166
Dependent Taxpayer	2,281	17	8	39	0	0	769	3,114
Total	**$206,278**	**$180,813**	**$10,253**	**$48,829**	**$281**	**$91**	**$109,464**	**$556,009**

Source: Author's calculations based on D.C. tax data files.

filers were 22.7 percent of total returns but only 9.9 percent of tax liability. Single parents evidently have significantly lower taxable income than couples filing joint or combined separate returns.

INCOME

Derivation of taxable income for District tax laws begins with federal adjusted gross income. The District tax instructions indicate that the taxpayer must first complete his federal return before completing the District of Columbia tax return. District taxpayers may use all adjustments provided under the federal income tax, although there are a series of add-backs as well.[22] *Excluded* from District gross income are: 1) interest and dividend income on federal obligations or U.S. securities that are includable in federal gross income; 2) interest on District obligations and other state and local bonds; 3) state and local tax refunds includable in federal taxable income; 4) income received during nonresidence; 5) social security and Tier 1 railroad retirement income; 6) interest and dividend income reported on federal form 8814; 7) pension and annuity income; and 8) amounts previously taxed as unincorporated business tax.

The total value of these subtractions is substantial. In tax year 1995, District taxpayers reported on their District tax returns $10.191 billion in federal adjusted gross income, additions of $23.6 million, and subtractions of $1.015 billion; District adjusted gross income in 1995 was $9.179 billion.[23] For those District tax returns for which federal tax returns could be matched, District federal AGI was 98.7 percent of AGI on the IRS transactions file.[24]

Personal exemption, deductions, tax rates

The District's adjusted gross income is reduced to taxable income by reductions for the larger of the standard or itemized deductions, and personal exemptions. A standard deduction of $2,000 is available for Single, Head of Household, and Married Filing Jointly filers, and $1,000 each for Married Filing Separately or Married Filing Combined Separate. Alternatively, the taxpayer may take itemized deductions shown on their federal return (Schedule A) with add-backs for deductions taken during periods of nonresidence, and deductions for District taxes. As noted earlier, the District's income tax has three income brackets, and three marginal tax rates (Figure I-5).

Additional personal exemptions are accorded for those over age 65 and blind. Figure I-6 compares the tax entry points for the federal income tax and state income taxes for the District, Maryland, and Virginia to the federal poverty level for households of size one to nine for 1995. The District, Maryland, and Virginia each has gross tax entry points at below one-half of the federal poverty line. It is evident that the federal income tax generally does not tax persons or households below the poverty line.

Figure I-5

D.C. Income Tax Rate Schedule, Form D-40

Taxable Income	Tax Rate
Less than $10,000	6% of Taxable Income
$10,000–$20,000	$600 + 8% of excess over $10,000
More than $20,000	$1,400 + 9.5% of excess over $20,000

For a District couple of three (husband, wife, and one child) with earnings at the poverty threshold of $12,267, the couple's taxable income would be $6,157 ($12,267 minus the standard deduction of $2,000, minus $4,110 for the three exemptions (3 x $1,370)). Gross tax due would be $369 (.06 x taxable income of $5,157); however, the Low Income Credit for 1996 for this family (joint return with three exemptions) is $494 and thus eliminates taxation of the family at the poverty line. If the husband worked full-time to earn the $12,267, he would be subject to District withholding and have to file a return to obtain the refund due to the Low Income Credit.[25]

Maryland alleviates the potential problem of taxing low-wage workers below the poverty line in two ways. First, Maryland has a $11,800 minimum federal AGI filing requirement for joint returns, ($6,550 for Single returns, and $8,450 for Head of Household). Second, the Maryland personal income tax does not tax incomes that are less than the poverty line (the so-called poverty income deduction). For the above family of three in 1996, earnings below the poverty income level of $12,980 are subtracted from federal adjusted gross income before the standard deduction and exemptions are deducted from federal AGI. Thus, in Maryland the family of three would be tax-free since income reduced by earnings would be further reduced by the standard deduction and the value of personal exemptions. Finally, since the local county income tax is a percentage of the state (60 percent in Montgomery and Prince George's counties), the household would not pay a local income tax.

Virginia partially addresses the problem of taxing households with income at or below the poverty line through a rate schedule with four brackets: 1) 2 percent for taxable incomes under $3,000; 2) 3 percent for taxable incomes of $3,000–$5,000; 3) 5 percent for taxable incomes of $5,000–$17,000; and 4) 5.75 percent for incomes in excess of $17,000. Thus, for a family of three (husband, wife, one child) in Virginia earning the poverty line of $12,267, the first $7,400 of earnings is tax-free (adjusted gross income is reduced by the $5,000 standard deduction plus the exemptions of $2,400 (3 x $800)). The taxable income of $4,867 is subject to a tax of $116.01 (2 percent of the first $3,000 or $60 plus 3 percent of the remaining $1,867 or $56.01).

Figure I-6

Federal Poverty Line and Gross Tax Entry Points

Federal, D.C., Md., and Va. Individual Income Taxes

		1995 Federal Tax		1995 D.C. Tax		1996 Md. Tax		1996 Va. Tax	
Household Size	1995 Poverty Line	Entry Point	Percent of Poverty Line	Entry Point	Percent of Poverty Line	Entry Point	Percent of Poverty Line	Entry Point	Percent of Poverty Line
1	$7,763	$6,400	82.4%	$2,370	30.5%	$2,700	34.8%	$3,800	49.0%
2	10,504	11,500	109.5	4,740	45.1	5,400	51.4	6,600	62.8
3	12,267	14,000	114.1	6,110	49.8	6,600	53.8	7,400	60.3
4	15,455	16,500	106.8	7,480	48.4	7,800	50.5	8,200	53.1
5	18,330	19,000	103.7	8,850	48.3	9,000	49.1	9,000	49.1
6	20,965	21,500	102.6	10,220	48.7	10,200	48.7	9,800	46.7
7	23,482	24,000	102.2	11,590	49.4	11,400	48.5	10,600	45.1
8	25,818	26,500	102.6	12,960	50.2	12,600	48.8	11,400	44.2
9	25,597	29,000	113.3	14,330	56.0	13,800	53.9	12,200	47.7

Credits against the income tax

As already noted, D.C. tax law accords low-income earners a Low Income Tax Credit. The District provides four types of tax credits.

- Individual income taxes required and actually paid to other jurisdictions. In 1995, 3,945 D.C. taxpayers took an average credit of $3,626 for income taxes paid to other jurisdictions; the total value of the credit (revenue cost) in 1995 was $14.3 million.
- A child and dependent care credit equal to 32 percent of the federal credit. In 1995, 15,337 D.C. taxpayers took an average child care credit of $190, and the preponderance (72 percent) were taken by Head of Household filers; the total value of the credit (revenue cost) in 1995 was $2.9 million.
- The low-income credit. In 1995, 11,099 D.C. taxpayers took an average low-income credit of $276; the total value of the credit (revenue cost) in 1995 was $3.1 million.
- A property tax credit available to homeowners and renters living in taxable real estate with gross income less than $20,000.[26] In 1995, 18,249 D.C. taxpayers took an average property tax credit of $370; the total value of the credit (revenue cost) in 1995 was $6.8 million.

PROGRESSIVITY OF DISTRICT INCOME TAXES: 1989 COMPARED TO 1995

While the primary purpose of any revenue source is to finance needed public services, the individual income tax also is used by many jurisdictions to achieve distributional objectives. Tax progression is usually defined to mean that the rate of taxation should rise with ability to pay. While there are a variety of ways to measure progression, perhaps the most intuitive is to examine across income classes the ratio of net taxes to as broad a measure of income as possible. This study measures ability to pay using federal adjusted gross income as reported to the District. Figure I-7 shows the number of taxpayers for 1989 and 1995 and three representative taxpayers in each income interval. For example, in the fourth income interval ($10,000–$15,000), there were 26,805 District taxpayers (aggregated to one filing unit). The third and fourth columns display the effective tax rate of the 25th percentile of the distribution of all 26,805 taxpayers, ordered from lowest to highest effective tax rate. That tax return showed an effective tax rate of 1.6 percent in 1995, and 2.3 percent in 1989.

In 1995, there were 364 taxpayers with federal adjusted gross income of $500,000 or more and effective tax rates of less than 5 percent. Inspection of this high-income, low effective-tax-rate group indicates that some of the taxpayers were in the District less than a year, and many had very large aggregate subtractions and itemized deductions. Unfortunately, the District does not enter the underlying detail of subtractions and itemized deductions into its tax database, so it is not pos-

Figure I-7

D.C. Effective Personal Income Tax Rates

1989 and 1995 Federal AGI Class

AGI Class	Number of Taxpayers		25th Percentile		Median		75th Percentile	
	1989	1995	1989	1995	1989	1995	1989	1995
$0–1,500	6,228	4,009	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
1,500–5,000	23,329	14,538	0.0	0.0	0.0	0.0	0.5	0.8
5,000–10,000	35,892	23,757	0.3	0.0	2.5	1.4	3.4	3.4
10,000–15,000	39,301	26,805	2.3	1.6	3.5	3.0	4.4	4.2
15,000–20,000	41,792	27,019	3.1	2.7	4.3	3.8	5.3	5.1
20,000–25,000	34,909	25,987	3.9	3.3	5.0	4.6	5.9	5.8
25,000–35,000	43,594	38,360	4.3	3.9	5.6	5.4	6.5	6.5
35,000–45,000	24,974	23,376	4.6	4.4	6.0	6.0	7.0	7.2
45,000–55,000	14,630	14,929	4.8	4.7	6.1	6.2	7.0	7.4
55,000–65,000	9,598	9,922	5.0	5.1	6.2	6.4	7.1	7.4
65,000–75,000	6,640	7,190	5.2	5.2	6.3	6.5	7.2	7.5
75,000–100,000	9,143	10,701	5.4	5.6	6.5	6.7	7.3	7.6
100,000–500,000	11,636	15,204	5.7	6.0	6.9	7.2	7.7	7.9
500,000+	900	1,040	3.0	3.3	7.4	7.3	8.4	8.5
Total	**302,566**	**242,837**						

Source: Author's calculations based on D.C. tax data files.

sible to ascertain the economic reality of the reductions in taxable income without examining individual returns.

The opportunity to deduct District taxes from the federal individual income taxes softens the impact of the District tax. Since federal marginal tax rates rise with income, it follows that federal deductibility is more valuable to higher-income taxpayers. It also follows that federal deductibility makes the overall impact of the District income tax less progressive.[27]

Figure I-8 shows the pattern of the District's effective tax rates for taxpayers who itemized in 1995 and for whom federal income tax information was matched. The marginal federal tax rate is approximated by the ratio of federal income taxes to federal adjusted gross income. Columns to the right show the effective tax rate with and without federal offset. For example, the $35,000–$45,000 income interval has 9,593 taxpayers. The first quartile effective tax rate is 3.8 percent, but after federal offset it is 3.5 percent. Moving across we note that the median District federal effective tax rate with federal offset is lower than the rate that does not take federal deductibility into account. (One can also note, by comparing Figure I-7 and Figure I-8, that itemizers in 1995 often had lower effective tax rates than all taxpayers.)[28]

COMPARISON OF TAX BURDENS WITH MARYLAND AND VIRGINIA

Each year the Office of Tax and Revenue publishes a comparison of tax rates and burdens across all major revenue sources with the major neighboring Maryland and Virginia counties.[29] The methodology of the analysis is to construct four hypothetical couples at incomes of $25,000, $50,000, $75,000, and $100,000. The composition of income between husband and wife, the nature of their transportation methods, and housing choices are chosen to represent realistic demographic groups. Figure I-9 displays the analysis using 1996 tax law. The top panel shows the estimated personal income tax burdens in dollars, and the bottom panel restates the District's personal income tax burden as a percentage of the suburban personal income tax burdens. For households with $25,000 in income, the District's personal income tax burden is 126 percent of the personal income tax burden in Montgomery and Prince George's counties, and 189 percent of the personal income tax burden in various Virginia counties. The high relative tax burdens reappear for the $100,000 couples. According to the analysis, District tax burdens are reasonably competitive with suburban Maryland for incomes in the $50,000 and $75,000 levels.

The economic and demographic situation

CENSUS DATA ON RESIDENT POPULATION: 1969–1994

As is well known, the resident population of the District has declined for a long period of time. The District's 1994 population was 75 percent of its 1969 level.

Figure I-8

1995 D.C. Itemizers: Effective Tax Rates With and Without Federal Offset

AGI Class	Number of Itemizers	25th Percentile		Median		75th Percentile	
		Without Offset	With Offset	Without Offset	With Offset	Without Offset	With Offset
$0–1,500	104	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
1,500–5,000	303	0.0	0.0	0.0	0.0	0.0	0.0
5,000–10,000	1,018	0.0	0.0	0.0	0.0	1.0	1.0
10,000–15,000	2,224	0.0	0.0	1.0	1.0	2.5	2.3
15,000–20,000	3,409	0.9	0.9	2.1	1.9	3.0	2.8
20,000–25,000	4,541	1.9	1.8	2.9	2.7	4.1	3.7
25,000–35,000	10,220	2.8	2.7	4.0	3.7	5.2	4.7
35,000–45,000	9,593	3.8	3.5	5.1	4.6	6.1	5.4
45,000–55,000	8,037	4.7	4.3	5.9	5.2	6.8	5.8
55,000–65,000	6,309	5.2	4.6	6.3	5.4	7.1	6.0
65,000–75,000	4,999	5.5	4.8	6.5	5.6	7.4	6.1
75,000–100,000	7,698	5.9	5.0	6.8	5.7	7.5	6.2
100,000–500,000	10,919	6.4	5.2	7.3	5.8	7.9	6.2
500,000+	581	5.1	3.6	8.0	5.6	8.7	6.0

Source: Author's calculations based on D.C. tax data files.

Figure I-9

Personal Income Tax Burden in 1996
D.C. and Neighboring Jurisdictions

Taxes	$25,000	$50,000	$75,000	$100,000
District of Columbia	$1,096	$2,695	$4,723	$6,842
Montgomery County	870	2,890	4,674	6,470
Prince George's County	870	2,870	4,642	6,434
City of Alexandria	580	1,796	2,997	4,269
Arlington County	580	1,808	3,014	4,292
Fairfax County	580	1,792	2,990	4,460

D.C. Personal Income Tax Burden as Percent of	$25,000	$50,000	$75,000	$100,000
District of Columbia	100.0%	100.0%	100.0%	100.0%
Montgomery County	126.0	93.3	101.0	105.7
Prince George's County	126.0	93.9	101.7	106.3
City of Alexandria	189.0	150.1	157.6	160.3
Arlington County	189.0	149.1	156.7	159.4
Fairfax County	189.0	150.4	158.0	153.4

Source: D.C. Office of Tax and Revenue.

A way to examine demographic trends is to examine the number of federal tax returns filed annually in the District, and those filed in neighboring states (Maryland and Virginia). The residence concept is the mailing address of the federal individual income taxpayer, and while the address may reflect the location of an accountant or tax attorney, over time the numbers are indicative of broad trends. Figure I-10 indicates that, overall, Maryland and Virginia experienced small increases in the number of federal tax returns filed from 1990 to 1995 (increases of under 5 percent) while the District's 1995 count of federal tax returns was about 86 percent of its 1990 level.

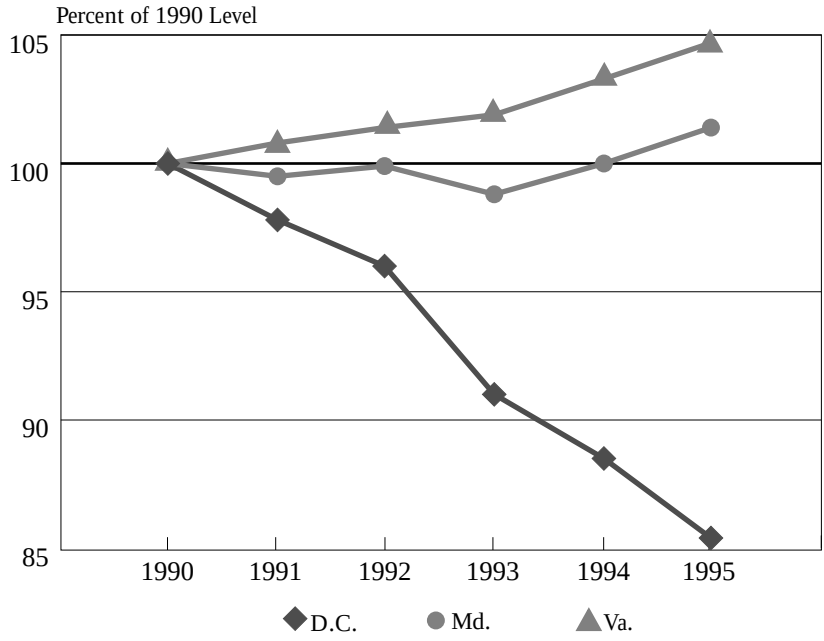
EMPLOYMENT AND SECURITY ADMINISTRATION TABULATIONS OF WAGES

Place of work

While resident population and federal tax returns show that the District is experiencing a consistent decline in residents and taxpayers, total wages paid in the

Figure I-10

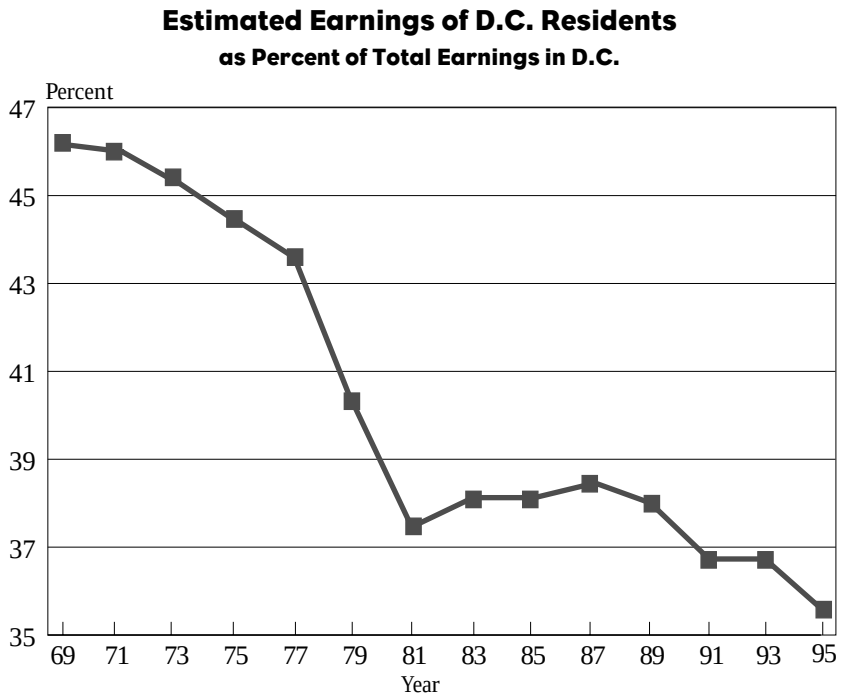
Trend in Relative Growth of Numbers of D.C., Md., and Va. Federal Returns
1990 = 100%



District — or measured by the place of work of the employee receiving the wages — have been rising steadily. The Bureau of Economic Analysis (BEA) estimates that from 1969 to 1994, total wages paid in the District grew from about $5 billion to about $27 billion. Figure I-11 displays the ratio of the BEA estimate of resident earnings (wages, salaries, and self-employment earnings, but not including capital income such as rent, royalties, and dividends and interest) to that of the total earned in the District. District residents' share of those earnings from employment fell from about 46 percent in 1969 to about 36 percent in 1995.

While the District experienced growth in earnings by place of work, it did not do as well as any of its suburban neighbors. If capital income is added to the above earnings concept, we see that the economic position of the suburbs grew far faster on an absolute basis (Figure I-12) than did their population. The Fairfax suburban area's 1994 resident wage and capital income was better than 1,200 percent of the 1969 level, while the District's resident wage and capital income level was slightly over 400 percent of its 1969 level.

Figure I-11



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

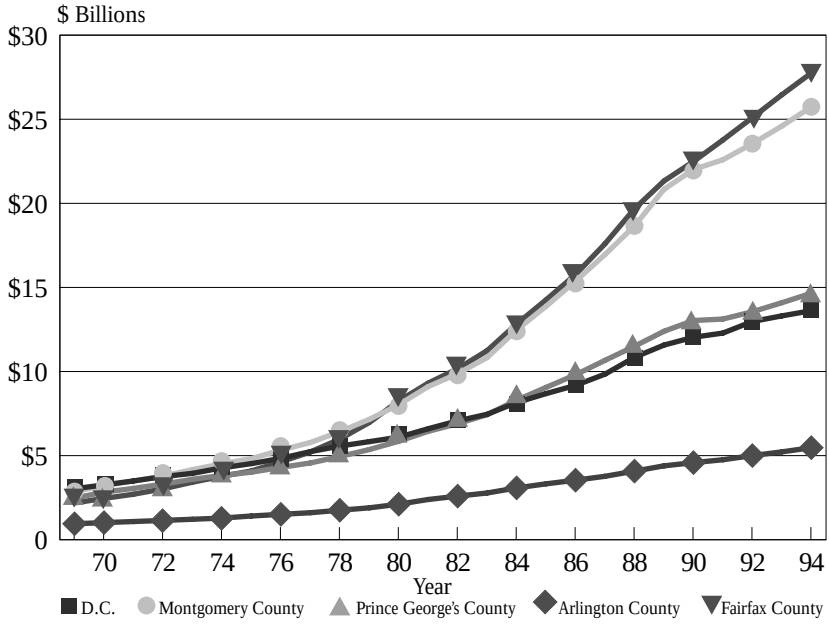
Place of residence

Figure I-13 shows the composition of the District's resident income base, again using BEA concepts, and it is evident that capital income has become somewhat more important and net earnings somewhat less important. Transfers (social security, AFDC, Medicaid, food stamps, public assistance, etc.) are shown as a percentage of nontransfer income, and they have grown from 15 percent to about 28 percent. In one sense this suggests a combination of greater generosity in transfer payments as well as a greater tax burden on the nonpoor and the federal government to finance these transfers. Resident wage earners are also being asked to help finance larger and larger service demands by nonresident workers (commuters).

In terms of the starting point of calculating District taxable income, the District's personal income tax base, as reflected on federal tax returns, has been stuck at the $10 billion–$10.5 billion level for the past seven years. Figure I-14 shows the total amount of AGI in Virginia and Maryland returns compared to the District, with 1990 set at 100

Figure I-12

Sum of Estimated Earnings and Capital Income
D.C. Metropolitan Area



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

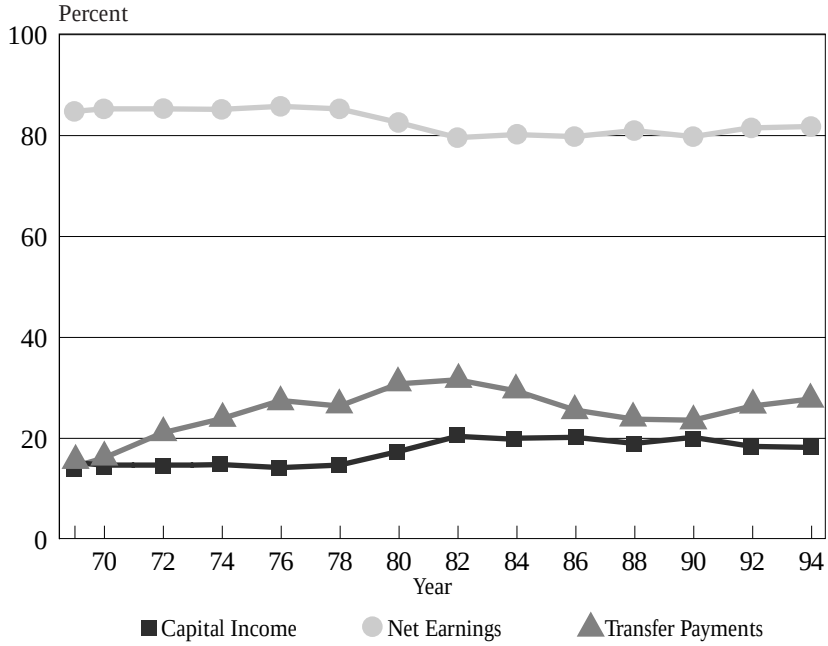
percent. While the District's total AGI rose less than 5 percent in the 1990–1995 period, Maryland's total AGI grew by almost 20 percent, and Virginia's AGI grew by 25 percent.

EMPLOYMENT AND WAGES OF DISTRICT RESIDENT AND NONRESIDENT WORKERS: 1980–1990

In 1990, 724,412 individuals were employed in the District, or 11.8 percent more than the 650,137 employed in 1980, and 43 percent more than the 504,611 employed in 1970. As noted above, this employment growth contrasts markedly with the resident population decline of the District. In 1980, the federal government was the single largest employer of District residents; however, in 1990, the service industry was the single largest industry employing District residents. During that decade, federal employment of District residents dropped 32 percent (Figure I-15). Overall, federal employment in the District was 212,000 in 1982 and 1990, but fell to 204,000 in 1994, and to

Figure I-13

Composition of D.C. Resident Income Base
Percent Share of Net Earnings Plus Capital Income



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

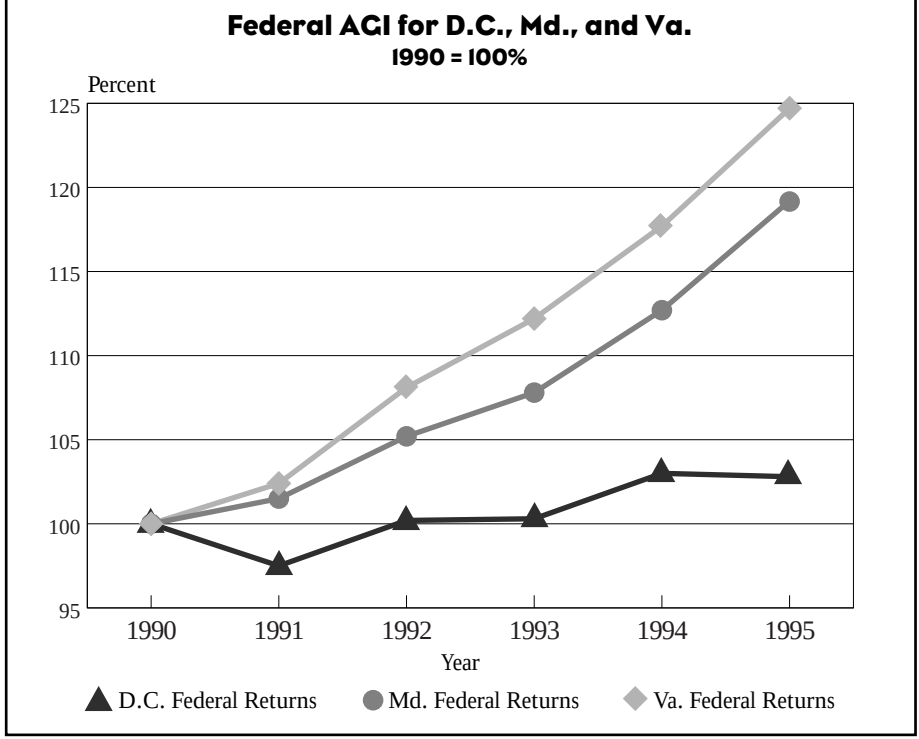
189,000 in 1998. Federal employment in D.C. of Montgomery County residents actually grew, but federal employment in the District fell among Prince George's County residents. Not only did service industry employment grow strongly for District residents (20 percent across the decade), it grew by 49 percent for Prince George's County residents, and 59 percent for Montgomery County residents.

District residents have generally held lower-paying federal jobs in the District than their commuting counterparts; this was also true in the service industry in both 1980 and 1990.

DISTRIBUTION OF FEDERAL AGI OVER TIME: 1989–1995

While the District's aggregate federal AGI has been stagnant, which implies stagnant District individual income tax revenues to the extent the two bases move together, an

Figure I-14



examination of the composition of the District's federal income tax base shows that the number of returns in the $0–$50,000 AGI classes has declined substantially, while the number of returns in the $50,000 or above AGI brackets has grown (Figure I-16). The amount of AGI attributable to the two lowest income classes has also fallen.

If we compare the number of returns in the lower AGI groupings in the District to those of Maryland and Virginia, we see that the number of the District's federal returns fell more dramatically than those of Maryland and Virginia. Also, the number of returns in the $50,000 and above classes grew more slowly in the District than those in Maryland or Virginia (Figures I-17, I-18, and I-19).

Migration into and out of the District of Columbia: Evidence from federal tax returns

As demographers are aware, change in an area's population is the net effect of natural increase, or in-migration, as well as out-migration. Each year the IRS' Statistics of

Figure I-15

Resident Employment Levels and Wages
Major D.C. Industries, 1980 and 1990

Area of Residence	1980 Jobs	1990 Jobs	1980 Wages	1990 Wages
Service Industry				
District of Columbia	68,207	81,921	$12,262	$26,731
Prince George's County	24,539	36,567	12,889	24,967
Montgomery County	22,877	36,399	21,195	45,044
Fairfax County	17,772	26,683	20,288	42,797
Arlington County	12,804	16,183	14,500	34,204
City of Alexandria	6,480	8,285	16,129	40,575
Federal Civilian Government				
District of Columbia	70,775	48,342	$17,139	$30,355
Montgomery County	25,830	27,284	27,173	44,259
Prince George's County	51,336	49,394	17,332	30,106
Fairfax County	39,629	39,899	26,192	45,185
Arlington County	15,523	14,112	22,264	40,294
City of Alexandria	10,689	8,592	21,109	38,804
Prince William/Manassas	5,548	7,069	22,263	40,086
State and Local Government				
District of Columbia	25,492	29,643	$14,204	$25,957
Prince George's County	14,596	17,613	18,037	30,624
Montgomery County	4,314	4,350	20,211	36,273
Arlington County	1,277	1,009	17,644	33,307

Source: U.S. Census Bureau.

Income Division analyzes the location of federal taxpayers in terms of their prior year's mailing address, and compares the number of returns to the prior year. Also, this data permits the identification of the origin and destination, in terms of state and county, of such movers.[30]

Figure I-20 shows that by the mid-1980s, the number of federal taxpayers moving *out of* the District grew dramatically — from about 21,000 to about 28,000 per year. At the same time, the number of federal taxpayers *moving into* the District fell

Figure I-16

D.C. Federal Tax Returns
1989–1995 (1989 = 100%)

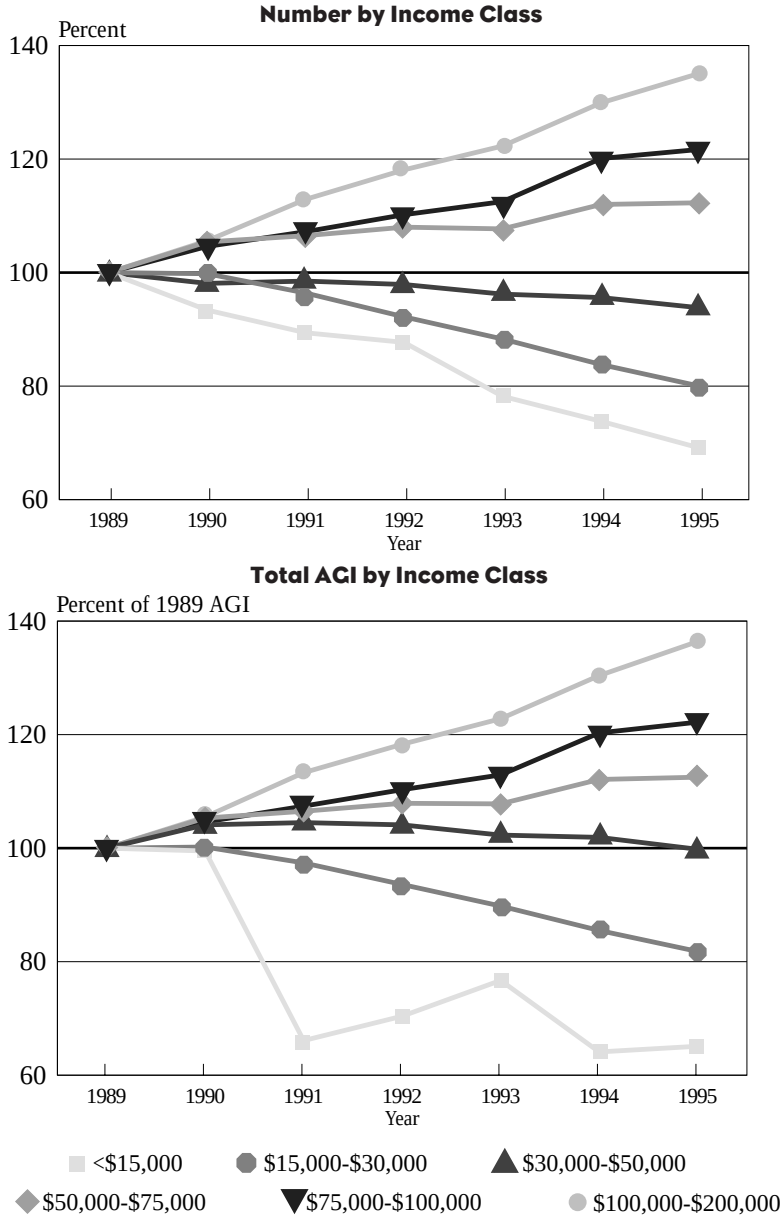
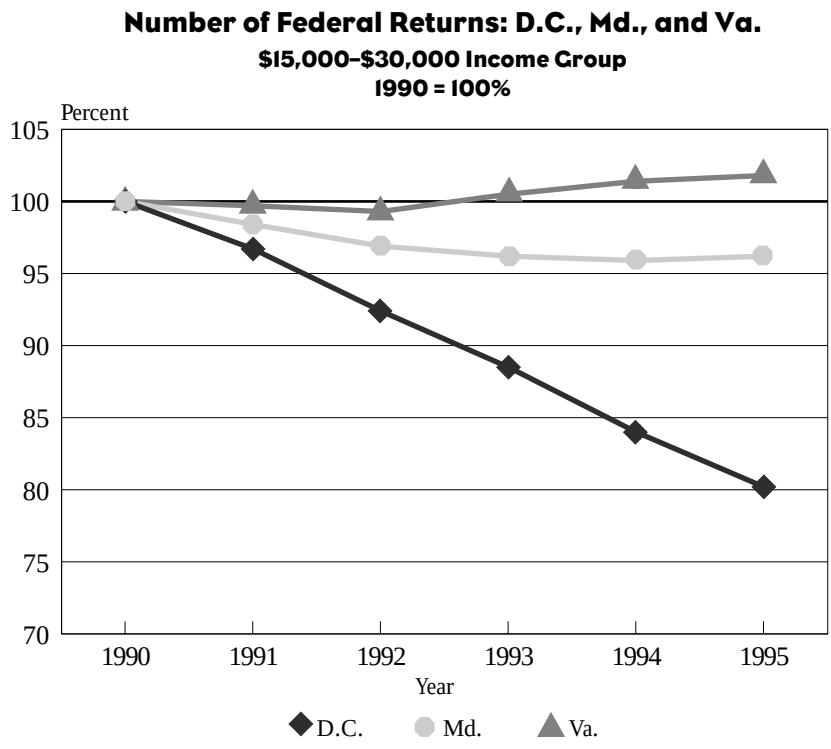


Figure I-17



off from a high of 24,500 in 1980–1981 to less than 21,000 in 1990–1991 and slightly more than 20,000 in 1995–1996. The difference between these two lines is the net out-migration.

Singles and couples have moved in, and larger households have moved out (Figure I-21). Since 1985–1986, the number of exemptions per return by filers moving into the District has fallen to around 1.4–1.5 exemptions per return, while the number of exemptions per return of out-migrants has risen to as high as 1.75 and closed at 1.7 in 1995.

These large flows into and out of the District have personal income tax administration implications. With about 26,000 federal tax returns departing with 1.7 exemptions per return, there are about 44,200 annual out-migrants. If we add to this number the 28,000 in-migrants (computed by multiplying the 20,000 returns by the average 1.4 exemptions per return), 72,200 out of 550,500 residents move in or move out each year. The gross turnover rate of 13 percent is well above the U.S. average of the population changing counties each year.

Figure I-18

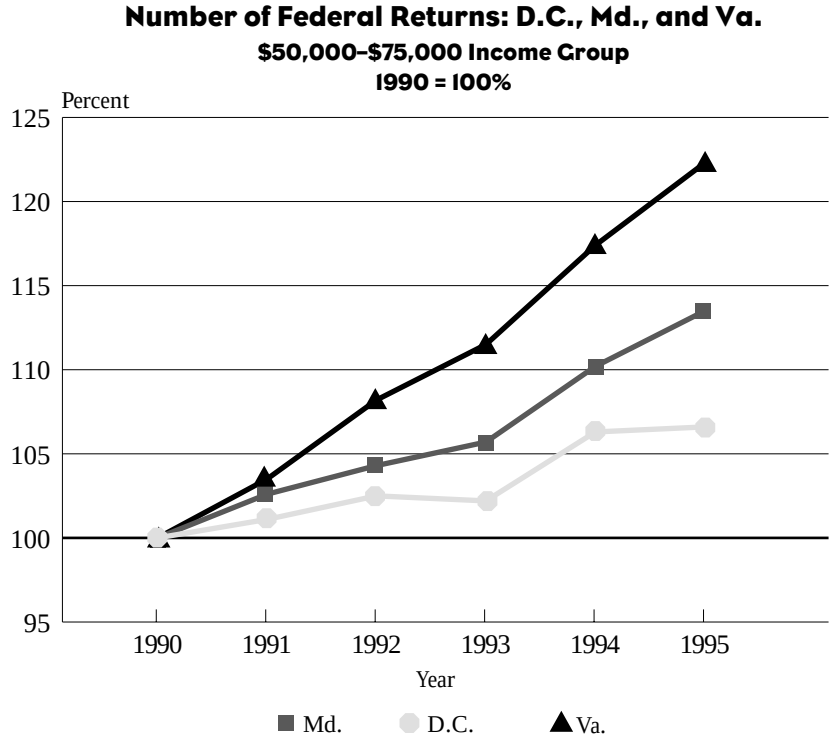


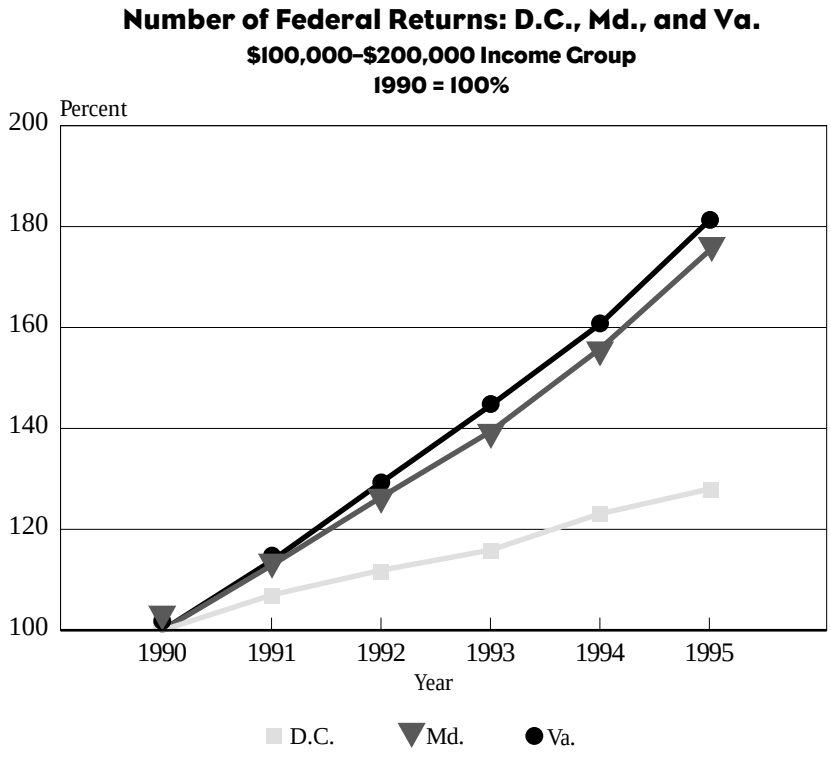
Figure I-22 displays the net of total exemptions on returns migrating in and migrating out. Since 1985–1986 the flow has been a net out-migration. It has been stable in the 1990s at about 15,000 per year. On a five-year basis that means that, on net, 75,000 persons reflected on federal tax returns have left the District.

Interestingly, if we examine the AGI per tax return of migrants, we see that out-migrants have slightly higher average AGI than in-migrants. The difference in 1995–1996 was on the order of $5,000 (Figure I-23).

ORIGINS AND DESTINATIONS OF MIGRANTS

The same federal tax return information from the IRS allows a more detailed geographic identification of the origin and destination of migrants. Focusing just on the number of returns, we see that Prince George's County historically has been the largest source of people moving into the District, on the order of 3,500–4,000 annually in the past five years, while Montgomery County lost about 2,000 movers annually into the District each year. Movement from subur-

Figure I-19



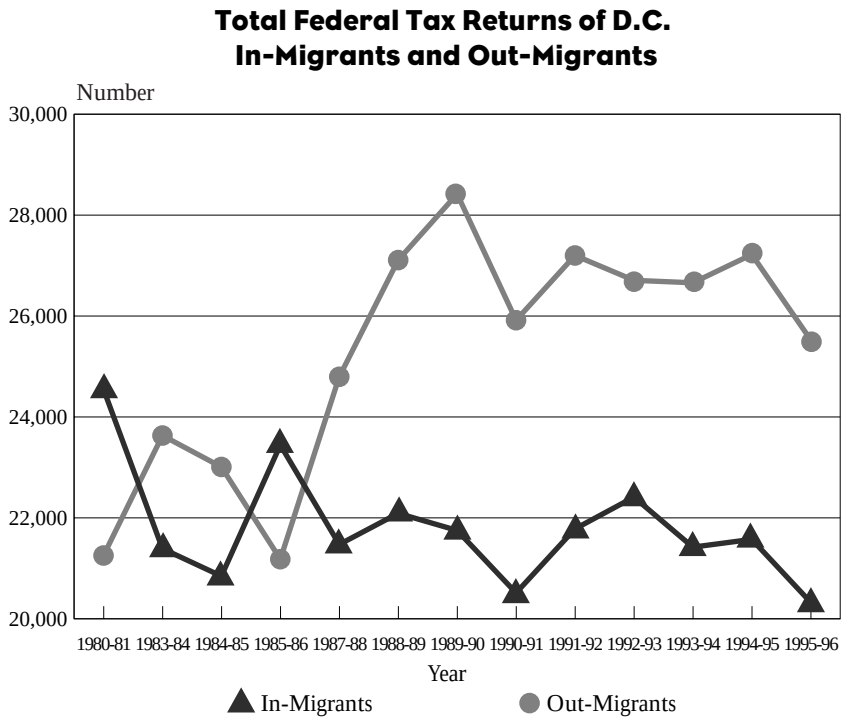
ban Virginia into the District was on the order of 1,000 per year (Figures I-24 and I-25).

For the last eight years, the District has lost annually about 7,000 federal tax filers to Prince George's County, and 3,000–4,000 to Montgomery County. Migration from the District to suburban Virginia was no more than 2,000 per year to Arlington County (which has been rising), and about 1,600 per year to Fairfax County. This implies that the substantial population growth in Fairfax County is not due to the District's out-migration but to other factors such as Fairfax County's gain in residents from outside the region (Figures I-26 and I-27).

Movers and stayers: evidence from District tax returns

Another way to examine the issue of the stability of the District's economy and its tax base is to examine the same taxpayers over time. As a consequence of having

Figure I-20



access to two years of District tax return data (1989 and 1995), it is possible to focus more completely on the nature of District in- and out-migration, and in particular the areas which seem to have experienced the greatest turnover in District taxpayers.

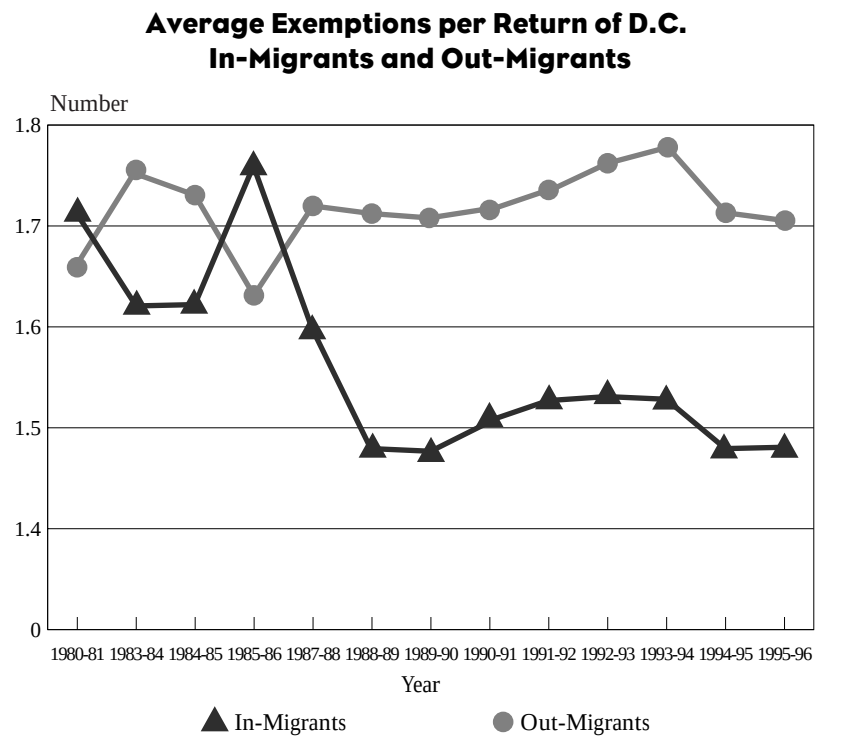
In 1989, approximately 310,000 District tax returns were filed, and in 1995, approximately 251,000 returns were filed. Figure I-28 compares the characteristics of movers and stayers.

An examination of the net taxable incomes of stayers vs. movers into the District in 1995 shows that the stayers generally tend to have higher income. The median net taxable income of singles present in 1989 and 1995 was $20,585 compared to $13,158 of those moving into the District.[31] This pattern is true across all filing types. Note also that the mean incomes are considerably greater than the medians, indicating that there are some very high-income filers (Figure I-29).

TAXES NOT PAID DUE TO OUT-MIGRATION

The out-migration of significant numbers of District residents over time undoubtedly has affected the revenue base of the District. The data from federal tax returns col-

Figure I-21

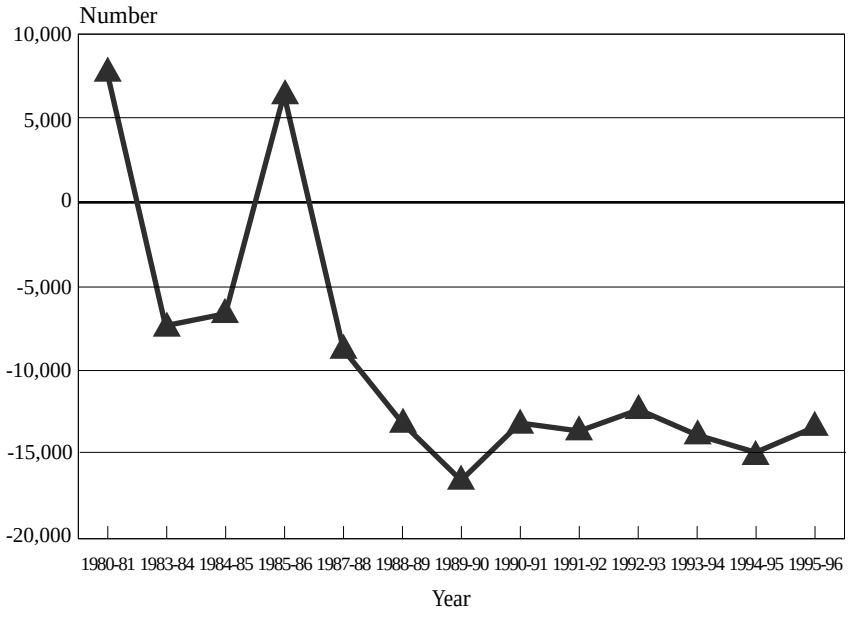


lected by the IRS indicates that, on average, out-migrants from the District had higher income than in-migrants, and that about 5,000 per year, on net, have been leaving. Given that the *average* AGI of those leaving has been about $34,000, the question arises of how much revenue has been lost from this net migration. The average tax payment attributable to taxpayers in the $25,000–$35,000 bracket is roughly $2,000, with about 5,000 net returns leaving with an average AGI of $34,000 (Figure I-30). We can make a first estimate of the revenue loss per year of the net out-migration: 5,000 taxpayers x $2,000 average taxes/taxpayer = $10,000,000 revenue lost.

A second approach to estimating the amount of revenues foregone due to the net out-migration of District residents is to examine the *distribution* of income of taxpayers in 1989 and 1995. The analysis is confined to taxpayers in 1989 and 1995 who had positive District taxes. Figure I-30 displays the distribution of taxpayers by federal AGI and compares the number of taxpayers in 1995 to the number of taxpayers in 1989 by federal AGI class. Overall, there was a decline of 60,523 tax-

Figure I-22

Net of Total Exemptions of D.C. In-Migrants and Out-Migrants



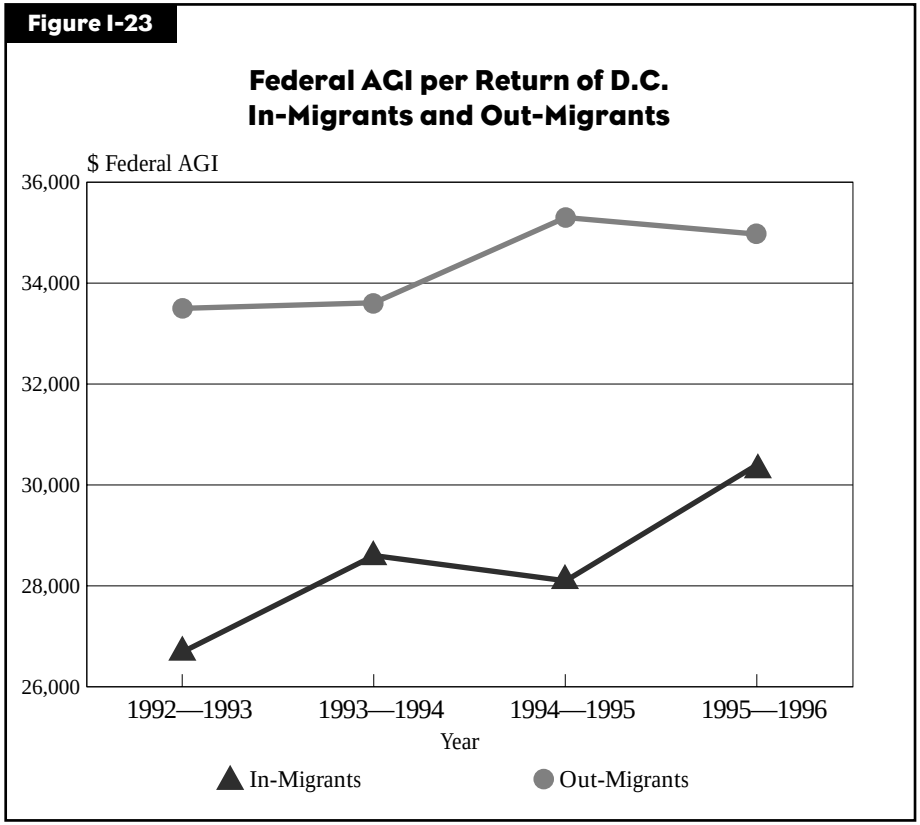
payers, with the decline occurring in the federal AGI classes from $1,500 to $45,000. Had these 60,523 taxpayers remained and paid taxes comparable to those with the same average AGI in 1995, the District would have collected an additional $39,113,889 in revenue. This compares to actual liabilities in 1995 of $556 million or 7 percent.

Note that this analysis assumes that the decline in tax returns by income class is due to out-migration; "departures" simply indicates that there were fewer returns in the income class in 1995 as compared to 1989. The number of tax returns grew in the higher brackets, especially the $100,000–$500,000 income class. This change could be due to in-migration as well as to better earnings for those who remained; their higher 1995 income put them in a higher income class in 1995 than in 1989.

MOVING AND STAYING WITHIN THE DISTRICT: A ZIP CODE ANALYSIS

This study analyzes movement within the District by examining tax filers who were present in 1989 and not present in 1995 (deemed to be out-migrants) and tax filers present in 1995 but not present in 1989 (deemed to be in-migrants). By taking the

Figure I-23



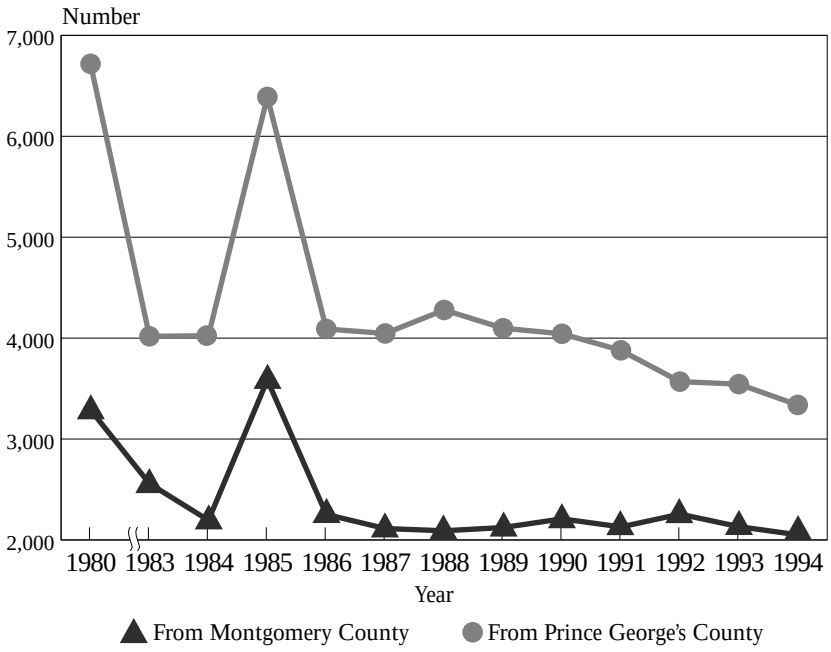
ratio of those leaving by zip code to the total number of 1989 returns by zip code, and the ratio of those coming into the District by zip code compared to the number of returns by zip code in 1989, we can get some idea of the spatial variability in migration patterns (Figure I-31).

EFFECT OF CRIME ON MOVING AND STAYING IN THE DISTRICT

A question arises about what might be the cause of the extreme variability observed in Figure I-31. The study of household location decisions typically focuses on housing demand, educational services, proximity to work and shopping, crime, and the price of foregone private consumption imposed by taxation. Recently, Nechyba and Strauss (1997) showed that location decisions, holding constant housing demand, and proximity to work and shopping, were quite sensitive to educational service quality as well as the level of crime in neighboring municipalities around Trenton, N.J. With regard to educational services, a 1 percent increase in educational services was associated with a 1.65 percent to 3.1 percent increase in the probability of moving to

Figure I-24

Federal Returns Moving Into D.C. From Md.
Montgomery and Prince George's Counties



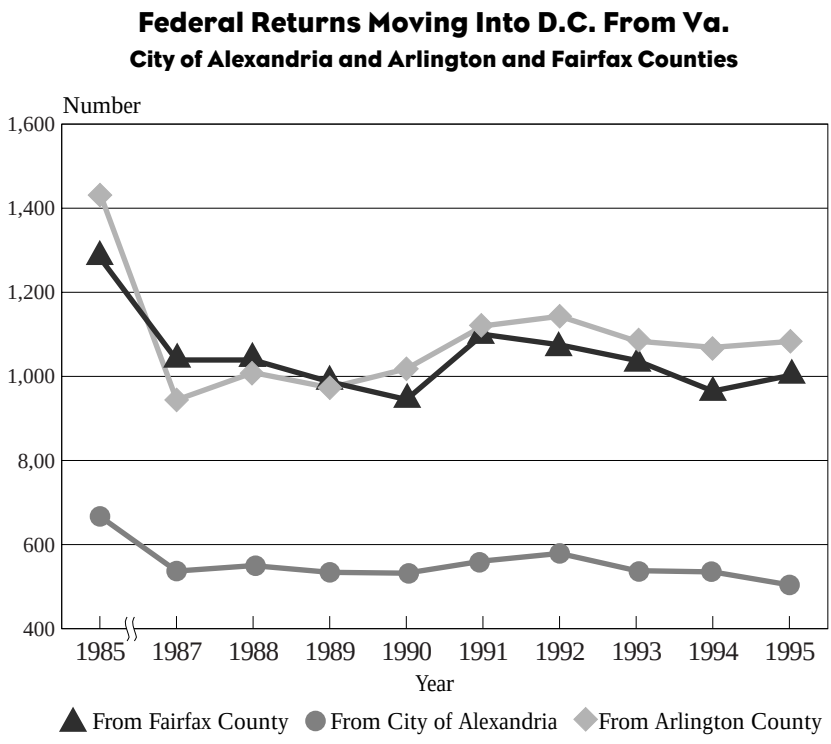
that jurisdiction. The elasticity of locating in a municipality given differential violent crime rates varied from -0.1 to -0.4; a 1 percent increase in violent crime is associated with a 0.1 percent to 0.4 percent reduction in the probability of moving to that jurisdiction.[32]

Cullen and Levitt (1996) found with a sample of 80 cities and 1980 census data that each additional reported crime is associated with a one-person decline in city residents. They find that "… almost all of the crime-related population decline is attributable to increased out-migration rather than a decrease in new arrivals to a city."[33]

To examine if differential crime in the District is associated with differential out-migration and in-migration over time, annual crime data were obtained from the District of Columbia Police Department. These data, which are different types of crimes reported to the Police Department, were aggregated from census tracts to zip codes, and then matched to the number of tax returns by zip code.[34]

Since population *changes* are of particular interest, the statistical model estimated was of the following form:

Figure I-25

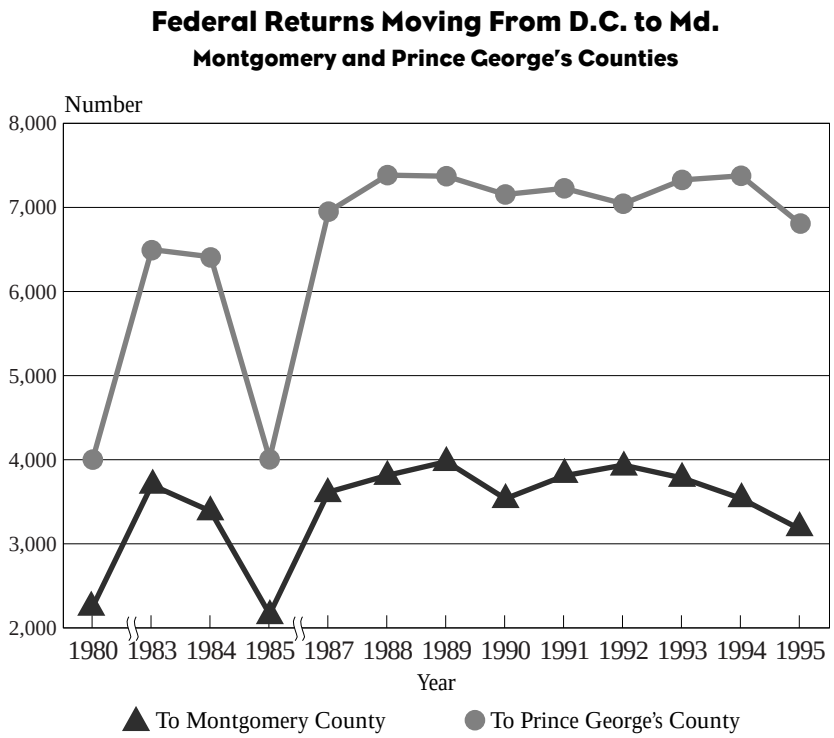


$$(Returns_{1995} - Returns_{1989})_{i'th\ zip\ code} = a + b(Crime_{1995} - Crime_{1989})_{i'th\ zip\ code} \quad (1)$$

Zip codes for which crime and tax returns in 1989 and 1995 could be matched showed that the average decline in number of tax returns per zip code was 3,256. Since the number of returns filed in 1989 generally exceeded the number of returns filed in 1995, we expect that as the number of crimes increased in 1995 compared to 1989, in a given zip code, that b should be negative, e.g., more crimes in an area compared to 1989 will "push out" taxpayers in 1995 compared to 1989 if out-migration is systematically related to crime.

Figure I-32 shows the statistical analysis results of different crimes. The first column shows the mean increase in crimes reported to District police, 1995 compared to 1989, by zip code. Overall, there were 275.9 more crimes per zip code reported in 1995 than in 1989; there were 5.7 more rapes per zip code reported and so forth. The second column displays the estimated effect of one more reported crime on the number of taxpayers in a zip code, 1995 compared to 1989. Thus, one more overall

Figure I-26

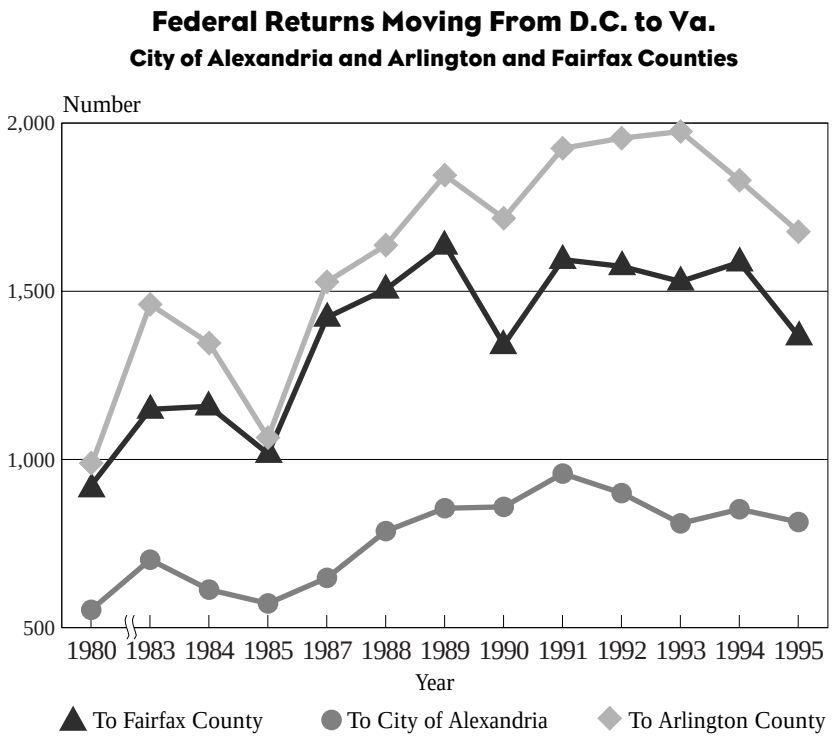


crime reported is associated with -2.7 fewer taxpayers in an average zip code in 1995 vs. 1989. The third column shows the probability that the associated effect is due to randomness; a value of 0.05 or smaller is extremely reliable. Finally, the fourth column shows the percentage of variation in the decline in taxpayers explained by the crime variable in question.

While there were not that many more rapes (5.7) reported in an average zip code in 1995 compared to 1989, the drop-off in taxpayers associated with one more rape is very large: 256.9. Note also that 79 percent of the variation in the decline in number of taxpayers is explained by the increased number of rapes.

A second way to examine the effect of crime on the number of taxpayers is to take advantage of what we know. That is, we examine all 1989 taxpayers who were no longer present in the District in 1995. Equation 2 states the relationship between the growth in crime by zip code on the number of taxpayers per zip code absent in 1995. That is, we estimate the effect of the growth in crime per zip code on the number of taxpayers who actually left the District in an average zip code. Figure I-33 displays the

Figure I-27



statistical analysis results. Because we are now predicting that more crime causes more taxpayers to leave, we expect that the effect of crime in this model will be positive.

We find, again, that increases in crime operate in the expected direction, and in statistically significant ways. Overall, an increase in one crime per zip code over the period 1989–1995 is associated with 5.3 taxpayers who are no longer in the District. This is about one departure per year or remarkably close to the results of Cullen and Levitt (1996). Again, one more rape is associated with a very large number of taxpayer departures (416.3), although the explanatory power is now lower than in the previous model (compare 79 percent above with 53 percent here).

$$(\text{Returns Absent in}_{1995})_{i\text{'th zip code}} = a + b(\text{Crime}_{1995} - \text{Crime}_{1989})_{i\text{'th zip code}} \quad (2)$$

Figure I-28

D.C. Tax Return Filing Characteristics of Movers Out of and Into the District
Comparison of 1989 and 1995

D.C. Filing Status	Movers Out of D.C.	Movers Into D.C.	Stayers
Single	118,641	82,029	53,202
Head of Household	42,828	32,677	23,156
Married Filing Jointly	17,453	11,458	12,044
Married Filing Separately	6,792	4,881	3,140
Married Combined Separate	14,727	6,952	12,741
Dependent Taxpayer		7,610	1,054
Total	**200,441**	**145,607**	**105,337**

Source: Author's analysis of D.C. tax return files.

Policy alternatives for the District's individual income tax

The sluggish individual income tax revenues noted at the outset, and the District's financial crises warrant a critical review of policy alternatives. However, "reform" of the District's personal income tax rests on an definition of the "problem" that may not be universally accepted. Moving towards any of three goals of a good tax system outlined earlier (revenue adequacy, simplicity and administrability, and distributional fairness) can readily imply different policies for the personal income tax, and, depending on one's behavioral assumptions, different policies. Moreover, without an agreed-upon revenue target for the District's overall own-source taxes, and a well defined role for the personal income tax, reform can take on an overall tax cut or tax increase flavor.

The following sections will discuss how the District's personal income tax might be changed to achieve, separately, each of the three good tax system objectives.

ENHANCING THE REVENUE PRODUCTIVITY OF THE DISTRICT'S INDIVIDUAL INCOME TAX

Supply side approaches

Were the District to engage in significant tax reduction as a strategy to make the District a more attractive place to live in comparison to surrounding areas (as has been suggested by a variety of policymakers), it is unlikely that greater economic

Figure I-29

Incomes of New and Continuing D.C. Residents
1995 and 1989 Compared

D.C. Filing/Resident Status	Mean 1995 Income	Median 1995 Income
Single		
In-migrants	$19,399	$13,158
Stayers	29,387	20,585
Head of Household		
In-migrants	11,933	8,915
Stayers	17,159	13,882
Married Filing Jointly		
In-migrants	36,975	16,911
Stayers	54,266	24,245
Married Filing Separately		
In-migrants	26,613	16,413
Stayers	35,716	20,386
Married Filing Combined Separately		
In-migrants	77,045	49,295
Stayers	108,319	62,199

Source: Author's analysis of D.C. tax return files.

growth in resident taxable incomes would occur quickly. The earlier analysis of BEA estimates of earnings by place of work showed that the District wages and self-employment income have been growing, albeit at a slower pace than in most suburban areas. Some of those commuter earnings would become resident earnings because of tax cuts. Relocation decisions would take time as commuters would need to be convinced that the tax reductions were likely to remain in place.

Meanwhile, personal income tax would be lower because District residents also would benefit from low tax rates. Without unusual improvements in service productivity, balancing the budget would require curtailing services. Should educational services and police protection deteriorate through higher crime rates, it is likely that the tax reduction would not be offset through greater migration into the city. Indeed, it might be that during the initial adjustment period, matters could compound to the disadvantage of the District.

Figure I-30

Distribution of Federal AGI and Average D.C. Taxes per Federal AGI Class

1989 and 1995 Compared

Federal AGI	1989 Returns	1995 Returns	Departures	Mean 1989 Taxes	Mean 1995 Taxes	Total 1995 Taxes	Taxes Not Paid Due to Departures
$0–1,500	50	148	0	$599	$2,161	$319,828	$0
1,500–5,000	7,344	4,765	2,579	50	70	333,550	180,530
5,000–10,000	28,066	14,903	13,163	206	216	3,219,048	2,843,208
10,000–15,000	36,857	22,849	14,008	445	414	9,459,486	5,799,312
15,000–20,000	40,841	25,773	15,068	761	671	17,293,683	10,110,628
20,000–25,000	34,381	25,420	8,961	1,147	995	25,292,900	8,916,195
25,000–35,000	43,035	37,851	5,184	1,631	1,509	57,117,159	7,822,656
35,000–45,000	24,654	23,094	1,560	2,351	2,206	50,945,364	3,441,360
45,000–55,000	14,441	14,717	0	3,010	2,907	42,782,319	0
55,000–65,000	9,480	9,771	0	3,685	3,623	35,400,333	0
65,000–75,000	6,546	7,085	0	4,414	4,319	30,600,115	0
75,000–85,000	9,027	10,552	0	5,509	5,468	57,698,336	0
100,000–500,000	11,499	15,045	0	9,260	11,640	175,123,800	0
500,000+	874	1,015	0	49,590	49,678	50,423,170	0
Total	**267,095**	**212,988**	**60,523**	**n.a.**	**n.a.**	**$556,009,091**	**$39,113,889**

Figure I-31

D.C. Out-Migrants and In-Migrants, by Zip Code, as Percent of 1989 Tax Returns

Zip Code	Out-Migrants	In-Migrants
20001	72.3%	42.2%
20002	68.7	37.4
20003	66.3	43.5
20004	69.3	114.8
20005	69.2	61.3
20006	71.6	40.0
20007	63.3	52.7
20008	59.9	53.0
20009	68.3	61.7
20010	70.9	54.5
20011	63.2	38.6
20012	58.1	36.4
20015	54.8	42.2
20016	58.8	44.3
20017	61.8	36.8
20018	61.6	34.8
20019	66.6	35.2
20020	65.9	36.7
20024	59.6	35.8
20032	68.9	35.8
20036	63.5	56.0
20037	57.8	49.9

Source: Author's calculations based on D.C. tax data files.

District and federal tax filers: A puzzle and revenue opportunity

When the District obtains tax return information from the IRS under its information exchange agreement, it receives all federal tax returns filed with a District mailing address. Analysis of data files with District tax return information indicates that about 50,000 District tax filers did not file federal tax returns (with District mailing addresses). A question arises as to whether those federal tax filers who used District of Columbia mailing addresses and who did not file District tax returns do in fact owe District income tax.

Figure I-32

Effects of Growth in Crime on Decline in D.C. Taxpayers
1989 and 1995 Data Compared by Zip Code

	Mean of Crime	"Push" Effect on Taxpayers (1995 Minus 1989)	PValue	R^2
Rape	5.7	-256.9	0.0001	0.7974
Street robbery	355.4	-5.3	0.0603	0.1371
Assault	85.2	-21.3	0.0003	0.4674
Burglary other	8.9	-53.9	0.0034	0.3237
Burglary home	152.6	-18.4	0.0037	0.3184
Auto theft	124.9	-10.1	0.0047	0.3032
Total reported crimes	**275.9**	**-2.7**	**0.0007**	**0.4009**

Source: D.C. Police Department and author's analysis of D.C. tax data files.

Comparing the 1995 District and federal files by social security number showed the following results (14,034 very late federal filers are not included):

- 200,209 filed both District and federal tax returns
- 50,735 filed a District tax return but did not file a federal tax return
- 51,405 did not file a District tax return but filed a federal tax return

While District tax information is not available for the federal taxpayers who did not file District returns, and for the very late District taxpayers, there is enough federal tax information to construct a simple District tax calculator based on federal filing status. Application of the calculator shows:

- the 51,404 taxpayers have a computed District liability of $83.2 million
- the 14,034 additional very late federal taxpayers have a computed District liability of $50.8 million

Thus, if all of the 65,438 taxpayers are indeed subject to District tax, individual income tax liabilities for 1995 would be $134 million or 24 percent higher.

Whether or not these taxpayers are legally subject to District income tax is beyond the scope of this study. As noted earlier, there are a variety of circumstances in which those with District mailing addresses are legally exempt from the District

Figure I-33

Effects of Growth in Crime on Number of D.C. Taxpayers Leaving D.C.
1989 and 1995 Data Compared by Zip Code

	Mean of Crime	Number Who Left	PValue	R^2
Rape	5.7	416.3	0.0001	0.5298
Street robbery	355.4	15.8	0.0008	0.4463
Assault	85.2	41	0.0001	0.5995
Burglary other	8.9	121.1	0.001	0.3995
Burglary home	152.6	40.1	0.0001	0.5563
Auto theft	124.9	24.5	0.0001	0.556
Total reported crimes	**275.9**	**5.3**	**0.0021**	**0.3388**

Source: D.C. Police Department and author's analysis of D.C. tax data files.

personal income tax. These federal taxpayers may elect to have their federal tax returns mailed to their place of work (they may be residents of Maryland or Virginia) or mailed directly to their tax advisors. Some of these taxpayers may be congressional or embassy employees who are exempt. These possibilities aside, 65,438 is a large number, as is the computed potential liability of $134 million, which is the outer bound of what might be collected under audit and compliance work. Presumably systematic investigation of these tax returns for District collection activity is worthy of consideration.

APPROACHES TO PIGGYBACKING THE DISTRICT'S INCOME TAX

In October 1972, the Congress enacted optional federal collection of state individual income taxes.[35] Upon prospectively entering into an agreement with the Secretary of the Treasury, a "qualified" state would have its income taxes collected by the federal government in such a manner as if the taxes were imposed by the federal government. Supporters of the measure hoped that such a voluntary system would substantially simplify the efforts of taxpayers who were required under federal, state, and sometimes local law to maintain separate records because of the differences in information required by different income tax provisions.

Despite some obvious attractions, no state ever triggered the system, and in 1990, the provisions were eliminated from the Internal Revenue Code as part of an omnibus budget package that eliminated so-called "deadwood" provisions of the IRC.

In January 1997, President Clinton in his State of the Union message proposed that the Internal Revenue Service take over responsibility for collecting and administering the District's individual income and payroll taxes. This plan was part of his proposed replacement of the $660 million annual "federal payment" to the District with federally provided services. Initially, the administration proposal provided for $15 million in fiscal year 1998 start-up costs, and $25 million a year in annual operating expenses for fiscal year 1999 and thereafter. Since the piggybacking provisions in the Internal Revenue Code no longer were operative, actual implementation of the proposal would have required federal tax legislation. Subsequently, the proposal to have the District income tax piggybacked as contemplated in the 1972 legislation was dropped.

While actual federal collection no longer is being actively discussed, moving the District's income tax to greater conformity with the federal income tax has been recommended for a considerable period of time. The District tax already uses much of the Internal Revenue Code. The starting point of any taxpayer's calculations is federal adjusted gross income as reported on his federal return, and many of the modifications rely on federal concepts.[36]

We explore here several different adjustments to the District income tax: 1) piggybacking the District income tax as a percent of federal liability with the federal filing unit; 2) moving the District income tax to the federal filing unit while maintaining the District's three tax brackets and rates, exemption structure, and deduction structure; and 3) moving the District income tax to the federal filing unit, using the federal standard deduction and exemption amounts, and using the District's three tax brackets and rates.

In the summer of 1997, Carol O'Cleireacain suggested replacing the District's individual income tax with a 28 percent surcharge on District liability along the lines of North Dakota, Rhode Island, and Vermont.[37] Figure I-34 displays the results of simulating the proposed 28 percent piggyback tax as a surcharge on federal liability as well as a revenue-neutral surcharge proposal. Several points about these simulations are important to keep in mind. First, they are based on matched 1995 District and federal returns whose total District 1995 liability was $446 million, well below total liability of $556 million. As long as those not in this portion of the universe of District returns are no different than the others whose federal returns were not available, using $446 million as a benchmark is accurate. Second, because actual tax return data are available, the total revenue effects of any scenario are inherently more accurate than those estimated from published *Statistics of Income* tables because those necessarily aggregate across filing units and different marginal tax rates.

With these caveats in mind, note that the 28 percent surcharge on 1995 federal liability would yield only $339 million from the same taxpayers or a 23.9 percent tax reduction. O'Cleireacain (1997) estimates with 1994 data that, overall, the 28

Figure I-34

Analysis of Piggybacking Proposals, Surcharge on Federal Tax

Tax Experiment	1995 Liability
Base Case	$446.5 million
28% Surcharge	$339.9 million
36.7% Surcharge (Revenue Neutral)	$446.5 million

Source: Author's calculations based on D.C. tax data files.

percent proposal would entail a 30 percent tax reduction, and that all taxpayers would receive a tax cut.[38]

Examination of the distributional effects of these two proposals with micro-data indicates that the 28 percent and 36.7 percent surcharges would lower the vast majority of District taxpayer's taxes compared to what they actually paid in 1995. High-income taxpayers would experience significant increases in their effective tax rates (and therefore actual tax payments since the comparison is being made to current law). Under the 28 percent surcharge, the 587 taxpayers with federal AGI over $500,000 for whom federal returns were available for surcharge analysis, the median tax rate in 1995 was 8 percent (Figure I-35). This is below the statutory rate of 9.5 percent because the value of exemptions and deductions reduce the liability below this theoretical maximum. Imposition of a 28 percent surcharge on high-income taxpayers would create a higher median effective tax rate of 8.7 percent, or a 7.9 percent increase in effective tax rate (and actual tax dollars). Taxpayers whose effective tax rate was in the 75th percentile would experience an increase in effective tax rate from 8.7 percent to 9.3 percent.

Figure I-36 displays the distributional effects of the 36.7 percent surcharge on federal tax liabilities that is revenue neutral across those taxpayers for whom both 1995 District and federal tax returns were available. It is evident that the taxpayers in the highest income class will experience very substantial tax increases as a result of this form of piggybacking. Note that the highest income taxpayers, whose effective tax rate was in the 75th percentile, would experience an effective tax rate of 12 percent, or well above the current-law 9.5 percent top marginal tax rate.

ADMINISTRATIVE SIMPLIFICATION OF THE DISTRICT'S INDIVIDUAL INCOME TAX

A second approach to tying the District's personal income tax more closely to the federal personal income tax is to eliminate the various subtractions accorded

Figure I-35

Effect of a 28 Percent Federal Surcharge on 1995 D.C. Tax Rates

Federal AGI Class	Number of Taxpayers	25th Percentile			Median			75th Percentile		
		1995 Law	28% Surcharge	Percent Change	1995 Law	28% Surcharge	Percent Change	1995 Law	28% Surcharge	Percent Change
$0–1,500	3,078	0.0%	0.0%	-92.0%	0.0%	0.0%	-59.0%	0.0%	0.0%	-39.0%
1,500–5,000	10,987	0.0	0.0	-100.0	0.0	0.0	-100.0	0.5	0.0	-33.0
5,000–10,000	18,928	0.0	0.0	-100.0	1.2	0.0	-75.0	3.3	1.1	-59.0
10,000–15,000	22,141	1.6	0.1	-83.0	3.0	1.2	-57.0	4.2	2.0	-50.0
15,000–20,000	22,508	2.8	1.0	-66.0	3.8	1.9	-50.0	5.0	2.6	-45.0
20,000–25,000	21,749	3.5	1.6	-59.0	4.7	2.4	-49.0	5.8	3.0	-46.0
25,000–35,000	32,030	4.2	2.2	-54.0	5.6	2.9	-50.0	6.5	3.3	-45.0
35,000–45,000	19,543	4.7	2.6	-52.0	6.1	3.3	-44.0	7.2	4.3	-38.0
45,000–55,000	12,421	5.1	2.9	-49.0	6.4	3.8	-40.0	7.5	4.9	-34.0
55,000–65,000	8,190	5.4	3.2	-46.0	6.5	4.1	-37.0	7.5	5.1	-31.0
65,000–75,000	5,895	5.6	3.5	-43.0	6.6	4.4	-35.0	7.6	5.3	-29.0
75,000–100,000	8,543	5.9	3.8	-40.0	6.8	4.7	-33.0	7.6	5.5	-25.0
100,000–500,000	11,248	6.4	4.8	-32.0	7.3	5.6	-24.0	8.0	6.7	-6.7
500,000+	587	4.8	7.9	-2.3	8.0	8.7	7.9	8.7	9.3	67.0

Source: Author's calculations based on D.C. tax data files.

Figure I-36

Effect of a 36.7 Percent Federal Surcharge on 1995 D.C. Tax Rates

Federal AGI Class	Number of Taxpayers	25th Percentile			Median			75th Percentile		
		1995 Law	36.7% Surcharge	Percent Change	1995 Law	36.7% Surcharge	Percent Change	1995 Law	36.7% Surcharge	Percent Change
$0–1,500	3,078	0.0%	0.0%	-89.0%	0.0%	0.0%	-46.0%	0.0%	0.0%	-20.0%
1,500–5,000	10,987	0.0	0.0	-100.0	0.0	0.0	-100.0	0.5	0.0	-12.0
5,000–10,000	18,928	0.0	0.0	-100.0	1.2	0.0	-67.0	3.3	1.5	-46.0
10,000–15,000	22,141	1.6	0.1	-77.0	3.0	1.6	-43.0	4.2	2.7	-34.0
15,000–20,000	22,508	2.8	1.3	-56.0	3.8	2.5	-35.0	5.0	3.4	-28.0
20,000–25,000	21,749	3.5	2.1	-46.0	4.7	3.2	-33.0	5.8	3.9	-30.0
25,000–35,000	32,030	4.2	2.9	-40.0	5.6	3.9	-34.0	6.5	4.3	-28.0
35,000–45,000	19,543	4.7	3.4	-36.0	6.1	4.4	-26.0	7.2	5.6	-19.0
45,000–55,000	12,421	5.1	3.8	-33.0	6.4	5.0	-21.0	7.5	6.4	-13.0
55,000–65,000	8,190	5.4	4.2	-29.0	6.5	5.4	-18.0	7.5	6.7	-9.8
65,000–75,000	5,895	5.6	4.6	-25.0	6.6	5.7	-15.0	7.6	7.0	-6.3
75,000–100,000	8,543	5.9	5.0	-21.0	6.8	6.1	-11.0	7.6	7.2	-1.7
100,000–500,000	11,248	6.4	6.3	-11.0	7.3	7.4	-0.1	8.0	8.7	23.0
500,000+	587	4.8	10.0	28.0	8.0	11.0	42.0	8.7	12.0	119.0

Source: Author's calculations based on D.C. tax data files.

under District law (which amount to tax base reductions of $1 billion in 1995), and require District taxpayers to file on the same basis as they do for federal returns. This would eliminate the Married Filing Combined Separate class, and obligate them to file returns as Married Filing Jointly. This would impose a marriage penalty as their current splitting arrangement is designed to overcome this. Revenues would predictably rise. The simulation model indicates this proposal would raise $658.4 million of tax before credits (and $640.8 million in tax after credits) compared to the base case of $556 million from the same taxpayers at 1995 levels. The second simplification proposal of using federal instead of District standard deduction and exemption amounts, but continuing District brackets and tax rates, would create $572.9 million in revenues compared to the base case of $556 million.

Figure I-37 displays the effective tax rates by federal AGI class of the first simplification proposal:

- continued add-backs per District current law[39]
- mandatory District standard deduction amounts
- mandatory joint filing for Married Combined Separately (imposes marriage penalty)
- District bracket amounts and rate structure
- continued provision of all District tax credits

Several things are immediately evident from this distributional analysis. First, the elimination of itemized deductions tightens up the distribution of effective tax rates among higher-income households. The first quartile of effective tax rates is no longer 3.3 percent; it is 7.9 percent. Second, the median and third quartile effective tax rates for the highest income households moves toward 9.5 percent, the theoretical maximum effective tax rate. If the additional revenue which this proposal generates is too large, given the revenue goals of the District, then the top marginal tax rate of 9.5 percent could be lowered and/or the brackets widened to account for the 8 percent inflation since their inception.

Figure I-38 displays the second simplification proposal:

- continued add backs per District current law (see endnote 39)
- mandatory federal standard deduction amounts (no itemizing); $3,900 for Single Taxpayers, $6,500 for Joint Returns, $5,750 for Heads of Household, $3,275 for Married Filing Separately
- federal personal exemption amounts of $2,500
- mandatory joint filing for Married Combined Separately (imposes marriage penalty)

Figure I-37

Distributional Effects of Replacing D.C. Income Tax With Simplified Tax

1995 Federal Taxpayers With D.C. Returns

(Federal Filing Unit, Mandatory D.C. Standard Deduction and Exemption Amounts, and D.C. Rate Structure)

Federal AGI Class	Number of Taxpayers	25th Percentile Tax Rate		Median Tax Rate		75th Percentile Tax Rate	
		Current Law	Proposal	Current Law	Proposal	Current Law	Proposal
$0–1,500	4,009	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
1,500–5,000	14,538	0.0	0.0	0.0	0.0	0.8	0.9
5,000–10,000	23,757	0.0	0.0	1.4	0.0	3.4	3.2
10,000–15,000	26,805	1.6	0.0	3.0	2.7	4.2	4.2
15,000–20,000	27,019	2.7	0.0	3.8	3.9	5.1	5.2
20,000–25,000	25,987	3.3	0.0	4.6	5.1	5.8	5.9
25,000–35,000	38,360	3.9	4.3	5.4	6.3	6.5	6.8
35,000–45,000	23,376	4.4	6.1	6.0	7.2	7.2	7.5
45,000–55,000	14,929	4.7	7.0	6.2	7.7	7.4	7.9
55,000–65,000	9,922	5.1	7.5	6.4	8.0	7.4	8.1
65,000–75,000	7,190	5.2	7.8	6.5	8.2	7.5	8.3
75,000–100,000	10,701	5.6	8.1	6.7	8.4	7.6	8.5
100,000–500,000	15,204	6.0	8.5	7.2	8.8	7.9	8.9
500,000+	1,040	3.3	7.9	7.3	9.3	8.5	9.4

Source: Author's calculations based on D.C. tax data files.

Figure I-38

Distributional Effects of Replacing D.C. Income Tax With Simplified Tax

1995 Federal Taxpayers with D.C. Returns

(Federal Filing Unit and Mandatory Federal Standard Deduction and Exemption Amounts)

Federal AGI Class	Number of Taxpayers	25th Percentile Tax Rate		Median Tax Rate		75th Percentile Tax Rate	
		Current Law	Proposal	Current Law	Proposal	Current Law	Proposal
$0–1,500	4,009	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
1,500–5,000	14,538	0.0	0.0	0.0	0.0	0.8	0.0
5,000–10,000	23,757	0.0	0.0	1.4	0.0	3.4	0.7
10,000–15,000	26,805	1.6	0.0	3.0	0.0	4.2	2.6
15,000–20,000	27,019	2.7	0.0	3.8	1.3	5.1	3.6
20,000–25,000	25,987	3.3	0.0	4.6	2.7	5.8	4.8
25,000–35,000	38,360	3.9	1.5	5.4	4.7	6.5	5.7
35,000–45,000	23,376	4.4	3.9	6.0	6.1	7.2	6.7
45,000–55,000	14,929	4.7	5.4	6.2	6.8	7.4	7.3
55,000–65,000	9,922	5.1	6.1	6.4	7.2	7.4	7.6
65,000–75,000	7,190	5.2	6.6	6.5	7.5	7.5	7.9
75,000–100,000	10,701	5.6	7.1	6.7	7.7	7.6	8.1
100,000–500,000	15,204	6.0	7.8	7.2	8.3	7.9	8.6
500,000+	1,040	3.3	7.8	7.3	9.2	8.5	9.3

Source: Author's calculations based on D.C. tax data files.

- District bracket amounts and rate structure
- continued provision of all District tax credits

This simplification proposal is analogous to basing the District personal income tax on taxable federal income but with no itemization. It would achieve tax entry points of the federal income tax shown earlier in Figure I-5 (page 327). As with the above simplification proposal, the distribution of effective tax rates "tightens up" considerably, and the lower and moderate family incomes are more favorably treated than current law. The effective tax rates in federal AGI classes up to $45,000 in Figure I-37 are lower than the effective tax rates under current law. Yet, overall, tax revenues are roughly comparable ($572 million) to the base case of $556 million.

A second way to compare the effects of the alternative based on the federal filing unit and mandatory federal standard deduction and exemption amounts, is to look at representative dollar amounts of taxes due under 1995 law and this alternative. Figure I-39 makes such comparisons by filing unit. Panel A shows how the alternative would impact single taxpayers. Overall there are 117,060 single tax returns to analyze. For single taxpayers in the $35,000–$45,000 federal AGI class, the median tax payment under 1995 law was $2,621. Under the proposal, the median tax payment would be slightly higher at $2,763. Since there were 11,475 single taxpayers in the $35,000–$45,000 federal AGI class in 1995, this means that half of the single taxpayers had 1995 taxes due below $2,621, and half had more than $2,621 due; this is the definition of the median. Again, focusing on the $35,000–$45,000 federal AGI class, we see that one-quarter of the taxpayers in that income class had tax payments below $2,163, and three-quarters of the taxpayers had tax payments above $2,163. Note that at the 25th percentile the tax payment rises to $2,516 under the alternative tax scheme. Finally, the 75th percentile tax payment amount is $2,940 under 1995 law, and $3,044 under the alternative. Generally, the alternative narrows the variation in taxes due compared to 1995 law, primarily because it eliminates itemization. Differences remain based on adjustments permitted in getting to federal adjusted gross income.

The largest differences in tax payments occur for a relatively small number of very high-income taxpayers (federal AGI over $500,000) in the Married Filing Separately category (Figure I-39, Panel C). Otherwise, the movement in tax payments does not appear to be unacceptably large. It should be remembered that the alternative is being developed on the basis of revenue neutrality — total personal income taxes under the new system are the same as they were under the 1995 system. The advantages of this simplified system are far greater conformity to the federal individual income tax by virtue of relying on the same definition of the filing unit and a taxable income concept that can be taken directly from a federal return, including the same standard deduction and exemption amounts. This simplified

Figure I-39

Distribution of Taxes under 1995 Law and Reform Alternative
Panel A: Single

Federal AGI Class	Number of Taxpayers	25th Percentile Tax Due		Median Tax Due		75th Percentile Tax Due	
		1995 Law	Proposal	1995 Law	Proposal	1995 Law	Proposal
$0–1,500	21,220	$0	$323	$0	$945	$0	$2,037
1,500–5,000	1,756	3	28	60	90	124	207
5,000–10,000	8,196	191	90	255	170	326	262
10,000–15,000	11,417	355	388	477	511	579	638
15,000–20,000	11,299	588	814	810	941	964	1,080
20,000–25,000	11,422	986	1,260	1,225	1,388	1,373	1,530
25,000–35,000	18,599	1,488	1,754	1,772	1,964	2,058	2,214
35,000–45,000	11,475	2,163	2,516	2,621	2,763	2,940	3,044
45,000–55,000	7,270	2,847	3,141	3,461	3,547	3,788	3,842
55,000–65,000	4,469	3,629	3,807	4,248	4,267	4,664	4,592
65,000–75,000	3,081	4,394	4,471	5,040	5,014	5,613	5,418
75,000–100,000	3,793	5,459	5,487	6,311	6,088	6,945	6,639
100,000–500,000	2,980	7,918	7,953	9,412	9,343	12,556	12,701
500,000+	83	38,506	44,764	52,892	54,021	68,687	80,797
Total	**117,060**						

Panel B: Married Filing Jointly

Federal AGI Class	Number of Taxpayers	25th Percentile Tax Due		Median Tax Due		75th Percentile Tax Due	
		1995 Law	Proposal	1995 Law	Proposal	1995 Law	Proposal
$0–1,500	6,449	$0	$1,493	$0	$3,395	$0	$5,937
1,500–5,000	7	0	171	0	717	108	2,430
5,000–10,000	34	22	527	221	1,071	331	2,285
10,000–15,000	625	242	54	433	118	511	199
15,000–20,000	1,757	385	230	564	374	732	516
20,000–25,000	1,994	579	539	838	746	1,058	914
25,000–35,000	3,423	884	974	1,240	1,295	1,583	1,612
35,000–45,000	3,159	1,357	1,744	1,875	2,144	2,329	2,477
45,000–55,000	2,835	2,044	2,463	2,623	2,961	3,177	3,309
55,000–65,000	2,646	2,769	3,188	3,353	3,701	3,930	4,086
65,000–75,000	2,286	3,475	3,822	4,121	4,366	4,717	4,855
75,000–100,000	4,190	4,608	4,843	5,433	5,501	6,181	6,135
100,000–500,000	7,774	7,918	7,903	10,188	9,913	14,272	14,024
500,000+	481	40,322	43,598	49,676	53,633	66,194	75,758
Total	**37,660**						

Figure I-39, cont.

Panel C: Married Filing Separately

Federal AGI Class	Number of Taxpayers	25th Percentile Tax Due		Median Tax Due		75th Percentile Tax Due	
		1995 Law	Proposal	1995 Law	Proposal	1995 Law	Proposal
$0–1,500	1,241	$0	$700	$0	$1,436	$0	$2,430
1,500–5,000	21	13	32	84	149	137	212
5,000–10,000	225	195	90	269	184	342	302
10,000–15,000	393	335	389	490	528	622	674
15,000–20,000	474	531	728	790	918	952	1,079
20,000–25,000	600	863	1,076	1,177	1,330	1,372	1,532
25,000–35,000	998	1,176	1,445	1,625	1,795	1,929	2,060
35,000–45,000	533	1,836	2,003	2,355	2,506	2,778	2,851
45,000–55,000	339	2,537	2,664	3,165	3,195	3,637	3,596
55,000–65,000	224	3,328	3,224	3,980	3,853	4,440	4,271
65,000–75,000	133	3,996	3,674	4,718	4,584	5,328	5,203
75,000–100,000	183	5,284	4,504	6,136	5,581	6,841	6,372
100,000–500,000	186	7,539	6,817	9,196	8,950	13,215	12,220
500,000+	10	21,016	46,568	52,268	58,120	66,278	69,499
Total	**5,560**						

Panel D: Head of Household

Federal AGI Class	Number of Taxpayers	25th Percentile Tax Due		Median Tax Due		75th Percentile Tax Due	
		1995 Law	Proposal	1995 Law	Proposal	1995 Law	Proposal
$0–1,500	6,614	$0	$341	$0	$722	$0	$1,421
1,500–5,000	32	0	215	0	420	5	1,005
5,000–10,000	164	16	37	148	96	269	201
10,000–15,000	4,958	291	84	373	162	440	279
15,000–20,000	7,803	465	339	582	496	705	638
20,000–25,000	7,316	702	670	908	877	1,060	1,036
25,000–35,000	8,701	1,066	1,116	1,369	1,401	1,653	1,680
35,000–45,000	4,252	1,697	1,827	2,169	2,210	2,510	2,519
45,000–55,000	1,911	2,433	2,497	2,918	2,922	3,334	3,288
55,000–65,000	811	3,149	3,183	3,668	3,612	4,149	4,071
65,000–75,000	364	3,781	3,819	4,464	4,366	4,974	4,804
75,000–100,000	341	4,960	4,873	5,643	5,445	6,282	6,029
100,000–500,000	268	7,674	7,442	9,232	9,116	13,294	13,448
500,000+	8	33,711	40,231	42,970	47,092	51,635	58,862
Total	**43,543**						
Total Taxpayers	**204,033**						

system could be administered on a single-page form, yet continue to provide existing District tax credits enacted for various other purposes. It is likely that compliance will be substantially enhanced as a result of this greater conformity. Unfortunately, the fiscal value of greater compliance cannot be readily estimated. The disadvantage of greater conformity is that some taxpayers who benefit from itemized deductions will find their tax payments rising.

Dimensions of taxing District commuters

The financial and political positions of capital cities are often precarious and controversial. When Margaret Thatcher became the Tory prime minister of Great Britain, she disbanded the Greater London Council which had been dominated by the Labor Party for many years, and distributed its activities to 33 consolidated boroughs throughout metropolitan London. To make her point lasting, she sold the historic London County Hall to a Japanese investor who turned it into a luxury hotel. Most recently, Labor prime minister Tony Blair has created a London City Council with, for the first time, an elected mayor of London.

The Canadian solution to financing their national seat of government has been to create a two-tier system of local government and to empower the first tier of government to finance its provision of municipal services through a local property tax. The local tier includes narrowly defined Ottawa, and the second tier includes neighboring suburbs, all within Ontario. Canadian law obligates the national government to make payments to the city of Ottawa (tier one) in lieu of property taxes, although the measure of the payment is the application of tier one millages to the negotiated value of all federal properties. Conflict over municipal finances is thus dealt with during negotiations over the market value of federal property.

Historically, the District has had one of the highest ratios of nonresident workers to residents of any city in the United States. As of 1990, 493,716 nonresidents worked in the District; District residents who worked numbered 304,426 (including 67,694 who work outside the District).[40] There are several different philosophic perspectives one might adopt about how a nation's capital should finance its services; however, it seems likely that most would agree that commuters who use municipal services at their place of work should, to the extent practical, pay for these services. Moreover, it seems likely that most would agree that the place of residence should recognize these tax payments through tax credits against resident income taxes. As already discussed, District, Maryland, and Virginia income taxes already recognize the wisdom of this for their residents. Also, some would argue (as the Virginia Supreme Court has) that the District already imposes a limited commuter tax on certain (but not all) nonresident unincorporated business income.

Were the Home Rule Charter to be amended, within the more general context of rationalizing the District's finances to provide for a commuter tax on nonresident wages, what sort of dimensions might reason lead it to have?

Logic might suggest, for example, that the purpose of the nonresident wage tax be to defray the cost of municipal (as contrasted with educational or income redistribution) services used by nonresidents. Income redistribution among the states and the District is already accomplished by the federal government through the federal income tax, and payments to the states and District based on a redistributive formula that compares the ability to pay of each area to the national average. Recall that District residents receive AFDC, Medicaid benefits, and the District, like each of the states, is reimbursed for these income maintenance programs based on the federal reimbursement formula.[41]

Logic might also suggest that whatever tax on commuter wages and self-employment income is to be levied, it should be limited in rate to some fraction of the resident rate in recognition that commuters spend only a portion of their day at their place of work. Simplicity argues for the fraction to be 8/24 or 1/3, and simplicity further argues for a flat-rate commuter tax. Given that the District's income tax rate varies from 6 percent to 9.5 percent, we have an upper-bound, therefore, of 2 percent–3.2 percent.

These two points suggest a variety of ways to devise a commuter tax from first principles. One might go through the District's budget and identify those services that are municipal, and determine the share to be borne by commuters. Let us suppose that $750 million represents the total services which are enjoyed by residents and nonresident commuters.[42] The $750 million rough figure would include indirect costs associated with these activities. Given that commuters were 62 percent of those working and enjoying District municipal services, the total gross cost to be financed by commuters would be $465 million.

The Bureau of Economic Analysis reported that District nonresident earnings were $21.9 billion in 1994; Carol O'Cleireacain estimates nonresident wages to be $17.3 billion.[43] These figures suggest a range of commuter tax rates of 2.1 percent–2.7 percent ($465 million divided by $21.9 billion and $465 million divided by $17.3 billion); multiplying these rates in recognition of the eight-hour work day then creates commuter tax rates of 0.7 percent–0.9 percent (2.1 percent divided by 3 and 2.7 percent divided by 3) and revenues of $465 divided by 3 equals $155 million or roughly a quarter of 1995 resident income tax liabilities.

Undoubtedly, one can work with these assumptions and figures to reach different rates of commuter taxes. However, the above arithmetic indicates that a commuter tax of 0.5 percent–1 percent on commuter wages and self-employment income can be derived in a logical way. How this relates to the existing tax on unincorporated business income and the exemption accorded to various professional services poses an interesting series of questions and is worthy of further research.

Summary and conclusions

The purpose of this chapter has been to review the District's individual income tax in terms of structure and empirical characteristics in relation to observed population shifts. Also, the chapter has sought to address how the District's income tax might be more strongly related to the federal personal income tax to aid tax administration and compliance.

The research has led to the following conclusions:

1. The decline in the District's population is similar in nature to what one observes in other major cities over a long period of time.
2. Relatively smaller filing units move into the District than leave, but the AGI of those moving in is higher than those leaving. However, the level of in-migration of taxpayers into the District has dropped off in the last five years. Prince George's and Montgomery counties are the two largest destinations for migration out of the District. They also are the two largest sources of migrants into the District.
3. Were the District to have retained those who left between 1989 and 1995, and had they paid average per return taxes for their household income class, 1995 District individual income tax liabilities would have been only $39 million higher.
4. These large annual migrations of taxpayers undoubtedly create substantial administrative burdens on the District government in its administration of the individual income tax. Lapses in administration and procedures can have very dramatic revenue implications. Given that the federal government is not as large an employer as in the past — and employment has been spread out among smaller employers — there is likely greater difficulty in the withholding system to maintain records and revenues.
5. The continued growth in earnings by place of work in the District suggests a vibrant economy, but the stagnation of the individual income tax base and revenues suggests to this researcher that the District may have more of a public service problem than a problem with taxes that are too high.
6. Statistical analysis of tax returns by zip code within the District demonstrates that increases in crime between 1989 and 1995 are associated with more taxpayers departing. The effects of another rape in a zip code are startlingly large on the decline in number of taxpayers.
7. The spectacular growth in Fairfax County probably has much to do with location of high-technology firms and a growing autonomous economy in the suburbs. This has been found in the Philadelphia metro area by researchers at the University of Pennsylvania. Long-term expansion of the Beltway and the

subway have probably encouraged this growth, as has the availability of more vacant land for development.

8. The research identified something on the order of $130 million in potential additional revenues that might be obtained by seeking to tax those whose federal tax returns have a District mailing address but who do not currently file a District tax return. It is unlikely that all of these are subject to District income tax, but surely some are, and their audit should result in further revenues to the District.
9. The annual D.C. Office of Tax and Revenue study suggests that there is not a great difference overall between the District's tax burden and those of its neighbors. It does, however, appear that the District may tax low-income wage earners somewhat more heavily. Coincidentally, taxpayers in the lower- (up to $45,000 of federal AGI) to middle-income brackets have been dropping in numbers far faster in the District than in suburban Maryland and Virginia.
10. Analysis of the effects of tying the District income tax more tightly to the federal personal income tax indicates that a simple surcharge on federal liability would have to be on the order of 37 percent to be revenue neutral and create significantly higher tax rates for high-income households. Whether this is politically feasible or not is an important issue.
11. It appears that simplifying the District personal income tax — by requiring that all taxpayers use the standard federal deduction and federal exemption amounts in conjunction with the historical District income brackets and tax rates — could be a more promising approach that would bring in roughly the same level of revenues and not cause the dramatic tax increases that the piggyback approach could cause.
12. As nonresident employment in the District has grown, the burden of providing municipal services to nonresidents increasingly has fallen on District residents. A 0.6 percent–0.9 percent tax on nonresident earnings is estimated to defray the costs of nonresidents' use of District municipal services.

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Endnotes

[1] Hellerstein and Hellerstein (1992), II, p. 20-2 and p. 20-3.
[2] Mississippi, Oklahoma, Massachusetts, Virginia, Delaware, Missouri, New York, and North Dakota by 1920; North Carolina, South Carolina, New Hampshire, Arkansas, Georgia, and Oregon by 1930.
[3] Idaho, Tennessee (on capital income), Utah, Vermont, Alabama, Arizona, Kansas, Minnesota, Montana, New Mexico, Iowa, Louisiana, California, Kentucky, Colorado, and Maryland.
[4] West Virginia, Indiana, Michigan, Nebraska, Connecticut (just capital income until 1991 when broadened to labor income), Illinois, Maine, Ohio, Pennsylvania, Rhode Island, and New Jersey; ACIR (1993), Table 14.
[5] See Kasarda, Appold, Sweeney and Sieff (1997) for a pessimistic appraisal of the likelihood that central cities can encourage such a turn-around in migration patterns, and the confirmation, using Current Population Survey data, that this is not happening despite occasional optimistic media reports.
[6] U.S. Census Bureau (1997).
[7] U.S. Census Bureau (1996), Table 472; U.S. Census Bureau (1997).
[8] 1975 figures due to Sunley and Wilensky (1978).
[9] This tension is not unique to the District. Many states with large central cities constantly must deal with political fights in their state capitols over how much assistance to provide for the dominant municipality and its school district vis-a-vis neighboring suburbs and rural areas. In New York, the friction is between New York City, its suburbs, and upstate New York. In Pennsylvania, it is between Philadelphia, its suburbs, and the rest of the state. In Michigan, it is between Detroit, its suburbs and the rest of the state, and so forth.
[10] U.S. Census Bureau, *Journey to Work.*
[11] Alabama, Arkansas, Mississippi, New Jersey, and Pennsylvania.
[12] Federation of Tax Administrators, FTP site, January, 1997.
[13] Sunley and Wilensky (1978).
[14] CCH, District of Columbia State Tax Reporter, ¶ 425.
[15] Hellerstein and Hellerstein (1992), II, p. 20-03.

[16] A person for Maryland personal income tax purposes is a resident if s/he: 1) is domiciled in Maryland on the last day of the taxable year; or 2) for more than 6 months of the taxable year, maintained a place of abode in this state, whether domiciled in this state or not. Maryland goes on to define a resident to include, for the part of the taxable year that an individual resides in Maryland, an individual who: 1) moves to Maryland with the intent to be domiciled in Maryland; or 2) is domiciled in Maryland and moves outside Maryland before the last day of the taxable year with the bona fide intention to remain permanently outside of Maryland. If an individual again resides in Maryland within 6 months after having moved outside Maryland, there is a rebuttable presumption that the individual did not have a bona fide intention to remain permanently outside Maryland.
Virginia defines a resident as follows:

> "Resident" for purposes of taxation, except as to Chapter 3 (Sec. 58.1-300 et seq.) of this title or as otherwise specifically provided, includes every person domiciled in the Commonwealth on the first day of any tax year, and every other person who has had his place of abode in the Commonwealth for the longer portion of the twelve months next preceding January 1 in each year, unless on or before that day he has changed his place of abode to a place outside the Commonwealth with the bona fide intention of continuing actually to abide permanently outside the Commonwealth.
>
> The fact that a person who has so changed his place of abode, within six months from so doing, again abides within the Commonwealth shall be prima facie evidence that he did not intend permanently to have his actual place of abode outside the Commonwealth. Such person so changing his actual place of abode and not intending permanently to continue it outside the Commonwealth and not having listed his property for taxation as a resident of the Commonwealth for the purpose of having his personal property listed for taxation in the Commonwealth, shall be deemed to have resided on the day when such property should have been listed, at his last place of abode in the Commonwealth. The fact that a person whose place of abode during the greater portion of such twelve months has been in the Commonwealth does not claim or exercise the right to vote at public elections in the Commonwealth shall not, of itself, constitute him a nonresident of the Commonwealth within the meaning of this term.

Virginia also provides for pro-rata tax liability by part-year residents in Sec. 58.1-303.
[17] Other characteristics of nonresident income which qualify as exempt service income are: 1) any trade or business that by law, customs, or ethics cannot be incorporated, 2) any trade, business, or profession that can be incorporated only under

the *District of Columbia Professional Corporation Act of 1971,* or 3) a trade or business engaged in by a blind person.

[18] Hellerstein and Hellerstein (1992), pp. 20–73.

[19] Virginia Supreme Court, No. 961290, April 18, 1997. The U.S. Supreme Court chose not to hear an appeal of it. (U.S. Supreme Court Docket No. 97-412, November 10, 1997.)

[20] Figure I-3, column 10, "total" row.

[21] Federal tax filers in the District were defined to be any taxpayer with a District of Columbia mailing address. Federal tax information was obtained by the D.C. Office of Tax and Revenue through its Exchange Agreement with the IRS, and provided to the author under an IRS-approved confidentiality agreement.

[22] Deductions for IRAs, uncompensated moving expenses, self-employed health insurance deduction, contributions to Keogh and self-employed pension plans, and deduction for alimony paid.

[23] The aggregate figure is somewhat different than the sum of the individual figures since negative incomes across taxpayers are not allowed to reduce the sum of District AGI.

[24] Given that the IRS file is a transaction file rather than a file of filed tax returns, the correspondence suggests good reporting by District taxpayers.

[25] Given a 2,000-hour year, this would mean working at $6.13/hour or slightly above the minimum wage. CCH, District of Columbia State Tax Reporter, ¶ 16-765, p. 1,692.

[26] The District individual income tax does not contain any refundable features beyond the property tax credit.

[27] If "t" is the D.C. effective tax rate, and "tfed" is the effective federal income tax rate, then deductibility means that the D.C. effective tax rate is t x (1-tfed). Since tfed rises with income, the D.C. offset tax rate will be lower than otherwise. Were the D.C. rate fixed at one tax rate, the offset effective tax rate would actually decline with income and thus be regressive overall.

[28] Note tha\t the effective tax rates in Figure I-8 include itemizers, so the comparison is not completely distinct.

[29] *A Comparison of Tax Rates and Burdens in the Washington Metropolitan Area.*

[30] The author wishes to thank the Division for providing this unpublished data to this project.

[31] Examination of movers who were only part-year residents does not alter this conclusion.

[32] Nechyba and Strauss (1997), Table 6.

[33] Cullen and Levitt (1996).

[34] The relationship between 1980 Census tracts and zip codes was obtained from the University of Missouri MABLE FTP site which maintains such data for the entire United States.
[35] Joint Committee on Taxation (1973).
[36] While the District tax law references the federal return the taxpayer is filing for District tax purposes, it never defines the federal return to be the actual signed return filed by the taxpayer in compliance with the filing requirements of the Internal Revenue Code, nor does it state that the tax year should be the same. The District taxpayer is obligated on the form (and in District tax statutes) to utilize the same form of deduction, either standard or itemized, as used for federal tax purposes, and in the case of Married Combined Filing Separately and Married Filing Separately, both classifications of District taxpayers must use the same form of deduction. While there may be a presumption that District taxpayers report from their bona fide federal tax return of the same year, it is not transparently stated. Moreover, if one reviews the District tax return, D.C. form D-40, it is evident that it does not reference specific line numbers of the (bona fide) federal return from which the taxpayer is to transfer the information. Whether or not taxpayers faithfully report from their bona fide federal return can not be determined from current District tax administration databases, because only the first page of the D.C. form D-40 is put into machine-readable form. Thus, supporting schedules are not available to cross-check with federal income tax data sources.
[37] O'Cleireacain (1997), p. 101.
[38] Ibid.
[39] In the case of adding back income taxes, use of this rather than the simulated proposal for add-back is inaccurate; however, the data available do not break out this particular figure.
[40] O'Cleireacain (1997), p. 106.
[41] I thus do not find persuasive the argument sometimes made that suburban residents have a responsibility to finance poverty programs in a nearby central city beyond the program each state legislature finances through state taxation of all state residents. Otherwise, one would create additional local incentives for local forum shopping. In my view, income redistribution should be financed by a government whose geographic reach is sufficiently large that most will not move to avoid taxes to finance income redistribution.
[42] Table 500 of the *Statistical Abstract of the U.S., 1996* reports that the District made direct expenditures of $496 million for highways, fire protection, and police protection in 1993.
[43] O'Cleireacain (1997), p. 108.