D.C. Tax Revision Commission Policy Options

Policy Option #58: Create More Brackets with Marginal Rates

MEMORANDUM

Proposal: Create more progressive tax brackets with marginal rates
Tax Type: Deed recordation and transfer tax
Origin: Rodney Green
Commission Goal: Fairness

Current Law

The deed recordation and transfer taxes (deed taxes) are imposed when taxable properties in D.C. are sold or transferred. The deed recordation tax is imposed on the recording of all deeds to real estate in the District (and is considered a tax on the buyer). At the same time, the deed transfer tax is also imposed on each transfer of real property (but is considered a tax on the seller). The deed recordation tax must also be paid on the increased value when commercial property is refinanced.

The basis of both taxes is the consideration (amount paid) for the property, including cash, property other than cash, mortgages, liens and a security interest in non-residential property. If there is no consideration or the consideration is nominal, the tax is based on the fair-market value of the property.

For all real property (other than residential properties valued at less than $400,000), the rate for each tax is 1.45% of total consideration or fair-market value. Therefore, the combined deed tax rate for a transfer of residential property valued at $500,000 or any commercial property would be 2.9%. For residential properties valued at less than $400,000, the rate for each tax is 1.1% of total consideration or fair-market value—for a total of 2.2%.

There is a “notch” effect with D.C.’s deed taxes because the rate on the entire transaction rises for a residential property valued at $400,000 or more. The total deed taxes due on a sale of a residential property valued at $399,000 would be $8,778 (0.022 x $399,000), but because of the notch effect the total deed taxes due on the sale of a residential property valued at $400,000 would be $11,600 (0.029 x $400,000), an increase of $2,822.

The District dedicates 15% of deed tax revenue to the Housing Production Trust Fund, which funds a variety of affordable housing programs. In fiscal year 2012, deed tax revenue totaled $284.9 million, with $163.4 million from the recordation tax and $121.5 million from the transfer tax.

Proposed Change

Differentiate the deed tax structure so the rate changes are gradual and more progressive.

Please see “Possible Rates and Revenue Estimates” below for a detailed description of proposed changes to the rate structure.
Reason for Change

The deed tax rate has two tiers for residential properties. This creates a “notch” effect at the $400,000 threshold for the higher rate. Creating a rate structure with marginal brackets would smooth the transitions from one bracket to the next while adding more brackets would make the structure more progressive.

Pros

- Would eliminate the “notch” effect, removing the incentive to price a home below $400,000 for tax reasons.
- Would make the deed taxes more progressive.
- Would differentiate rates more precisely according to value of transaction and phases in changes more gradually.

Cons

- Would make deed taxes more complex.
- Tax rates linked to the value of the transaction may not correspond closely to economic resources of the participants.

Possible Rates and Revenue Estimates

The Office of Revenue Analysis (ORA) estimates that in the first year of implementation the following residential deed tax rates would be revenue neutral (i.e., raise as much tax revenue as the current tax rates).

<table>
<thead>
<tr>
<th>Property Value</th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $400,000</td>
<td>0.5%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>$400,001 to $800,000</td>
<td>1%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
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<td>4%</td>
<td>3%</td>
<td>3.4%</td>
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<tr>
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<td>5%</td>
<td>4%</td>
<td>3.6%</td>
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<tr>
<td>$1,600,001 and above</td>
<td>9.5%</td>
<td>7.7%</td>
<td>3.9%</td>
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</tbody>
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