TAKING NEW YORK BACKWARDS:
PATAKI COMMISSION'S TAX CUTS EXACERBATE INEQUALITY AND FAVOR THE WEALTHY

DECEMBER 2013

A RESPONSE TO
NEW YORK STATE TAX RELIEF COMMISSION FINAL REPORT

I. INTRODUCTION

The recommendations of the Pataki-McCall Commission take New York backwards, with big new tax cuts for the wealthy and big corporations, at a time when the economic divide between the rich and low and middle-income families continues to grow. While states like California and Minnesota have been working to reduce income inequality and fund essential government functions adequately through progressive tax and budget policies, New York should be wary of adopting the same regressive tax policies that have failed the state before and will continue to jeopardize our future.

The Pataki Commission recommendations would result in staggering budget deficits to be paid for by New York's working families.

New York simply cannot starve itself of the revenue necessary to fund critical investments in education from pre-K to higher education; address pressing health care needs in the face of reduced federal support for hospitals; rebuild our social safety net at a time of historic rates of homelessness and child poverty; and make the investments in resilient and energy-efficient transportation infrastructure necessary to survive in the twenty-first century.

If the Pataki Commission recommendations appear similar to misguided tax reform efforts that New York has seen before, it is because they are. Pataki's steep tax cuts in the late 1990's failed to produce gains for the middle class, starved local governments of much-needed state aid and fueled the very property tax increases that his current commission ironically is seeking to now remedy.

Most New Yorkers recognize that austerity economics has failed, that new tax breaks for the wealthy and big corporations are economically unjustified, and that income inequality, low wages, stagnant employment and lack of aggregate demand for goods and services are crushing the New York economy. More than 700,000 New Yorkers remain unemployed and one in four have been jobless for over a year.

It is possible to craft progressive tax and budget reforms that would address the needs of most New Yorkers. But the Pataki Commission has failed to do that.

As the Commission seeks to cut another $2 billion in state revenue it should be noted that the last legislative session resulted in nearly $2 billion in tax cuts (over 3 years) currently scheduled to be implemented starting in 2014. These fiscally imprudent and politically motivated tax cuts include:

- Luxury condo tax breaks and elimination of the mansion tax for Donald Trump's properties.

- The minimum wage subsidy/tax credit – which incentivizes firing older workers to higher teenaged students[1] (but not out of school and unemployed teenagers) at the minimum wage and potentially gives huge tax breaks to big-box retailers like Wal-Mart.
- Start-Up New York – with no state taxes for 10 years for businesses that locate in or near SUNY campuses (and no personal income taxes for ten years for those businesses' employees).
- The $350 Family Rebate checks to be conveniently delivered just three weeks before Election Day but only for families with incomes above $40,000 (and as high as-$300,000) that had at least one dependent child on their 2012 tax returns).

This report critiques the recommendations of the Pataki/McCall Commission in substance and detail, demonstrating the flawed budgeting and severe inequity that would result from these proposals. This report will be followed by recommendations for better, fairer reforms that will work for all New Yorkers.

[1] This tax credit is only available for the hiring of teenagers who are enrolled in school. It is not available for hiring teenagers who are out of school and unemployed. In addition, this credit is only available for the employment of teenaged students if they are paid at exactly the minimum wage rate.

II. PATAKI PROPOSAL: $2 BILLION IN TAX CUTS BY 2016-17; OVER $5 BILLION BY 2018

The Commission recommends revenue reductions totaling an estimated $2.1 billion in 2016-17, growing to at least $2.5 billion in 2018-19 as its proposed estate tax cuts are phased in. This revenue reduction would grow to at least $5.7 billion per year thereafter if the Legislature were to adopt the Commission's recommendation that the state's current top income tax rate of 8.82% for families with taxable incomes above $2 million (and individuals with taxable incomes above $1 million) should be allowed to "reset" to 6.85% in 2018.

The Commission's $2.1 to $2.5 billion in enumerated revenue reductions consist of:

- $1 billion in property tax relief;
- $700 million in corporate tax cuts; and
- Estate tax "reform" estimated to cost $381 million in 2016-17 and $772 million in 2018-19.

If all of these recommendations (including the resetting of the top personal income tax rate) were to be adopted, approximately 70% of the $5.7 billion in tax cuts would go to the wealthiest one percent of New York households.

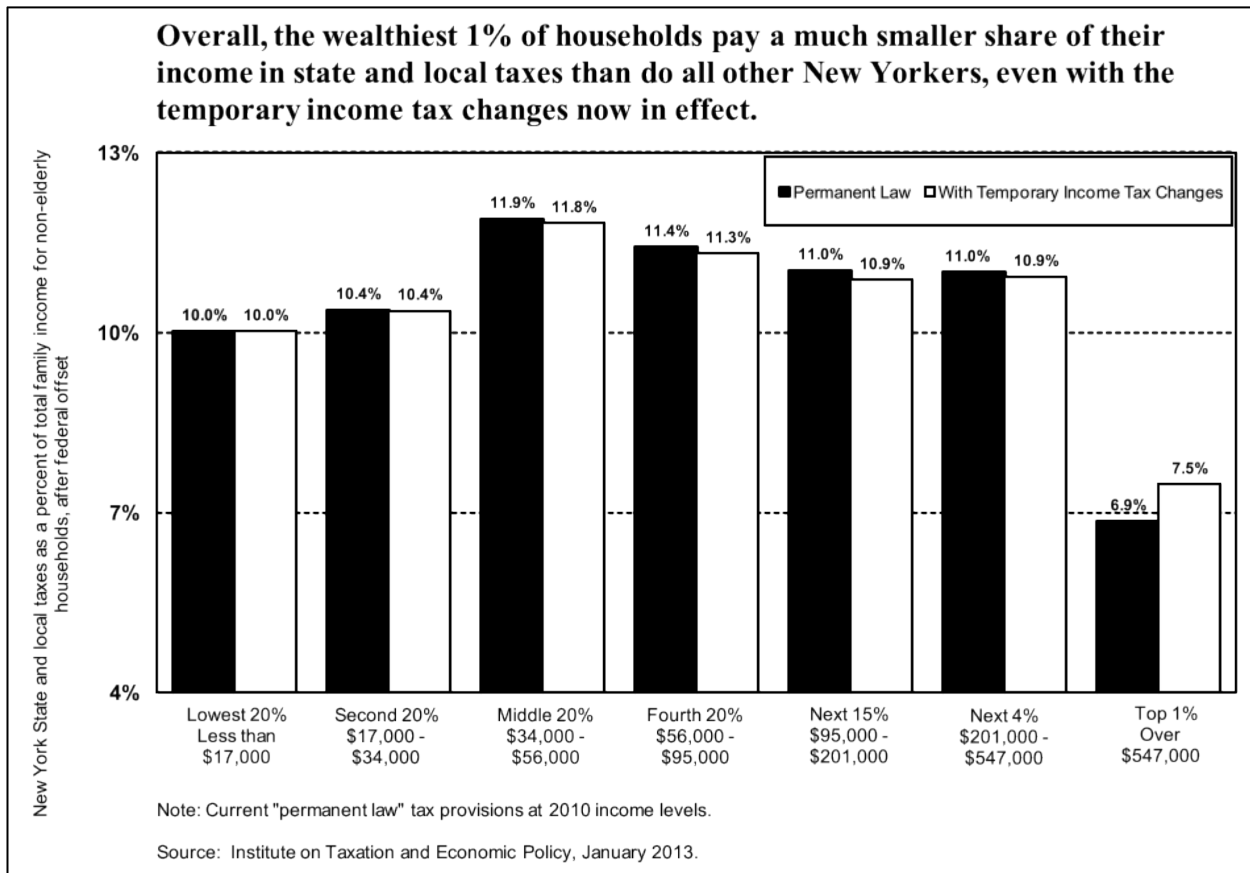
And, if the reduction of the top personal income tax rate was not included in the package, the wealthiest 3% of households would still receive over 30% of the $2.5 billion because of the magnitude of the estate tax cut. If the property tax relief proposals were not clarified to apply only to middle and lower income households, the share of the $2.5 billion going to the wealthy would be even greater.

WHY THESE TAX CUTS TAKE NEW YORK BACKWARDS:

TICKING TIME BOMB: Revenue reductions are back-loaded and will explode in cost in 2018 (similar to the plan proposed by Governor Pataki and rejected by the Legislature in 2006). The former Governor has a long history of proposing back-loaded, multi-year tax cuts that drain revenue and create out year budget gaps. In fact, the tax cuts enacted under former Governor Pataki have resulted in New York State collecting $16 billion less in annual state revenue and are responsible for the massive shift in tax burdens from the state to the local level.

AUSTERITY HURTS THE ECONOMY: The austerity measures necessary to keep the state budget balanced with a $2 billion revenue reduction, such as job cuts through attrition, inadequate investment in education and infrastructure, and a weakened social safety net – are likely to hurt the economy significantly more than any stimulus impact of new tax cuts for the wealthy and big banks.

BIG TAX CUT FOR THOSE WHO NEED IT LEAST: The most costly of the recommendations (which is not reflected in the report's assessment of the 2016-17 cost estimates), calls for allowing the state's top income tax rate of 8.82% to revert to its "permanent law" level of 6.85% for income received in the 2018 calendar year. The Pataki Commission asserts, without any substantiation, that this change is needed "in order to further strengthen New York's economic climate" – when the reality is that lack of aggregate demand and staggering income inequality is what is really damaging our state's economy. The wealthiest New Yorkers are already paying far less of their income in New York state and local taxes than working and middle class families. Having the personal income tax revert back to the previous permanent rate structure will result in even greater income inequality. By the state's own calculations, in 2014 the cost of allowing the top rate to revert back to 6.85% will cost $3.2 billion per year and then will grow in future years.



III. $1 BILLION IN PROPERTY TAX RELIEF FOR HOMEOWNERS IN 2016-2017

"FREEZE" SLAMS SCHOOLS & SERVICES IN HARDEST-HIT CITIES & TOWNS: The Commission recommendations include a property tax "freeze" for homeowners in jurisdictions that stay within the property tax cap enacted several years ago. In other words, it would freeze the property tax bills of only a portion of taxpayers at 2014 levels for a period of two years. If a homeowner's property taxes do increase in 2015 and 2016, the state will provide a rebate for any increase the homeowner incurs over 2014 tax levels, regardless of income.

The 'freeze' will only apply in taxing jurisdictions (city, town, village and school) that stay within the 2% limit of the property tax cap. The freeze also only applies to those taxing jurisdictions that consolidate local services within their town, city or school district. It is unclear whether the 'freeze' will remain in effect after year two and if it does, who will bear the burden of the costs of the rebate to homeowners.

This proposal adds perverse incentives to the pressure that the cap's rules already put on local governments to implement drastic cuts in schools and other important public services, which are already reeling from spending reductions which have occurred over the last several years. The cap rules are hardest on school districts which have to get a 60% majority vote in a public referendum to override the cap, and which are limited to the prior year's levy rather than the capped increase in certain cases.

This proposal alone seems to cost nearly $1 billion, leaving no funding for a targeted tax relief mechanism like a circuit breaker that actually delivers property tax relief based on need.

"RALPH LAUREN'S LAW" -- NO GUARANTEE OF FAIRNESS OR EQUITY IN DISTRIBUTING BENEFITS: Because the caps are instituted on a percentage basis, property tax increases possible under the cap are much greater for wealthy school districts than for needy school districts. Wealthier suburbs, with much higher property values, are able to raise more revenues with lower rates and therefore will benefit from freeze payments, while hard-pressed cities and towns that stretch to fund schools and services adequately will be penalized. The Commission did not pay attention to the principle of distributional equity in crafting the freeze—this could lead to a situation where Ralph Lauren gets a freeze-rebate tax break for his mansion in Bedford Hills but a harder-pressed low-income family in Yonkers or Mount Vernon gets nothing.

Because of differences (among the different town parts of school districts that encompass more than one town) in the rate and direction of year-to-year changes in equalization rates, it is possible to have a school district which stays within the property tax cap in terms of its overall levy but which has much bigger increases in the levy and the tax rate for one or more of the town parts of the school district. So, in the example below, in the first year of the tax cap (2012-13) this school district has an overall increase in its levy of less than 2% but homeowners in one part of the school district saw much greater increases in their tax bills. If the freeze rebate system had

been in place at this time (and if there were no income limits and no complicated safeguards), the owner of a $1.6 million dollar home in one town part of the school district would have gotten a freeze rebate of more than two thousand dollars while the owner of a $250,000 home in another town part of the same school district would not get a freeze rebate.

By basing the amount of a household's property tax relief on the change in its bill, rather than on the magnitude of its bill relative to its income, the relief is not being targeted to the homeowners that are overburdened. For the average homeowner in New York the 'freeze' credit will amount to the state paying for a pizza party for your family.

Owners of More Expensive Homes Will Receive Larger Rebates Under the Freeze Proposal

	Home A	Home B
Taxable Full Value of Home (Taxable Value After Exemptions)	$250,000	$5,000,000
Year 1 Tax Bill at $10.00 per $1000 of Taxable Full Value	$2,500	$50,000
Year 2 Tax Bill at $10.20 per $1000 of Taxable Full Value	$2,550	$51,000
Year to Year Tax Increase = Amount of Freeze Rebate	$50	$1,000

FREEZE BENEFITS UNDERMINE FOUNDATION FUNDING FORMULA: Again, the property tax increases possible under the cap-and-freeze mechanism are much greater for wealthy school districts than for needy school districts, so the money distributed to taxpayers under the proposed "freeze reimbursement rebate" system would provide much more "aid" to those wealthy districts than to the state's needier districts. This would result in the distribution of a substantial amount of money in a way diametrically opposed to the distributional patterns that would prevail if the state government were to honor its commitments under the foundation formula—a formula designed to ensure that no child receives less education funding than the "foundation" amount necessary for an adequate education.

FISCAL CRISIS OR TAX SLAM IN YEAR THREE: The proposed two-year freeze guarantees a fiscal "crisis" in the third year of the Commission's scheme, when there would have to be some combination of substantial cuts in local budgets increases in homeowners'

property tax bills, or a continuation of the program. It is unclear as to whether local districts will have to pick up the costs of the freeze after the second year and/or if the freeze will continue.

PROPERTY TAX PRESSURE RESULTS FROM STATE BUDGET CUTS & SPENDING SHIFTS: The rhetoric surrounding the cap and the proposed "freeze reimbursement rebate" system is designed to obscure the fact that the pressure on the local property tax is, in large part, related to the state government's cuts and freezes in state aid to education and revenue sharing with general purpose local governments. As the state share of funding services has declined over the years, it has resulted in more pressure placed on property taxes to pay for local services.

CIRCUIT BREAKER SHORT ON DETAILS & FUNDING: The Commission recommendations include creation of a new circuit breaker mechanism to provide a refundable tax credit for families paying a high percentage of their income in property taxes – with all details yet to come. Circuit-breaker proposals put forward by members of the Legislature in recent years have cost well over a billion dollars a year when fully implemented; the Commission's recommendations will likely push more money towards freeze rebates that benefit the wealthy rather than a more tailored and targeted circuit breaker.

COMMISSION PUNTS ON FAIRNESS: While recognizing that low and middle-income families and seniors on limited incomes face the greatest pressures from property tax expenses, the Commission fails to target relief to these New Yorkers; instead it says it is "open to different alternatives" which could target most of the billion-dollar proposal towards high-income high-wealth households.

INADEQUATE DETAILS ON DISTRIBUTION: Details are completely unspecified – there is no guarantee of fairness in distribution of tax breaks, and no explanation of the amounts intended to be delivered as tax subsidies under the freeze or tax credits under the "circuit breaker." This money should be used effectively to address affordability, depending on the parameters of the income-based relief mechanism recommended by the Governor in the Executive Budget (due to be presented to the legislature on January 21, 2014). We look forward to hearing from the Governor on how he will address this critical issue.

RELIEF NOT TARGETED WHERE IT IS NEEDED: Many low and middle-income New Yorkers are paying a large percentage of their income in property taxes. Only a circuit breaker will be able to target relief to these families -- and the commission report is very light on details on the subject. The chart below shows FPI's estimates of the total number of households who would be helped by a properly enacted circuit breaker.

More than 700,000 New York lower- and middle-income households* pay 10 percent or more of their income in property taxes. A quarter million pay 20 percent or more.					
	Estimated number of households whose property taxes paid in 2011 were:				
Household income range	**Less than 10% of income**	**10% to 19.99% of income**	**20% or more of income****	**10% or more of income**	**Total number of households in income range**
$50,000 or less	539,479	250,948	237,677	488,625	1,028,104
$25,000 or less	152,513	101,865	153,013	254,878	407,391
Above $25,000 but not above $50,000	386,966	149,083	84,664	233,747	620,713
Above $50,000 but not above $100,000***	832,026	N/A	N/A	213,667	1,045,693
TOTAL: All $100,000 or less	1,371,505	N/A	N/A	702,292	2,073,797

IV. MORE TRICKLE-DOWN ECONOMICS?: $1 BILLION IN CORPORATE TAX CUTS AND TAX BREAKS FOR THE WEALTHY – INCLUDING A SIGNIFICANT CUT IN THE ESTATE TAX – IN 2016-2017

ESTATE TAX CUT IS AN UNNECESSARY TAX BREAK FOR MILLIONAIRES: The Commission recommends raising the estate tax threshold from $1 million to $5.25 million and cutting the rate to 10%. This will cost about $400 million in FY 2016-17, and nearly $800 million two years later. The bulk of this windfall would go to a relative handful (fewer than 200) of the very wealthiest estates valued at $10+ million. The Pataki Commission can only justify this giveaway by totally ignoring research by the state's tax policy experts. In their recent report on the estate tax, the state's own experts concluded: "Migration studies regarding the impact of taxes such as the estate tax have shown that taxes generally are not a major factor in the decision of where to live or retire. …These papers generally show that taxes have very little impact on cross-state migration and estate tax revenues."[2] At a time when New York has the worst income inequality in the nation and record levels of homelessness, child poverty and long-term unemployment, providing gratuitous tax cuts for millionaires is counterproductive.

COMMISSION RECOMMENDS ELIMINATING MILLIONAIRES MINIMUM TAX: The Commission – apparently always looking out for those hard-pressed millionaires – proposes eliminating the PIT minimum tax, which is intended to ensure that high-earning individuals cannot exploit loopholes and eliminate all tax liability on big incomes. If the current minimum tax structure is not working, it should be improved – but the basic idea that those who make big money should pay a fair, minimum amount in taxes for public services is sound and must be retained.

TAXPAYER SUBSIDIES TO BIG CORPORATIONS & DEVELOPERS: The Commission's recommendation for a tax credit for manufacturers of 20% of their property taxes opens the door to a taxpayer subsidy for big corporations and developers, given New York State's track record of not being able to sustain the "targeting" of business subsidies over time[3] – and it will not carry out real reforms.

GAMING THE SYSTEM – FOR NEW BENEFITS: Our current business property tax system is warped beyond recognition by special subsidies and tax breaks for politically-connected corporations that have already manipulated the system through Industrial Development Agency benefits, negotiated tax breaks and legal challenges. The Commission's proposed 20% credit wouldn't just go to manufacturers paying their full property tax bill; it would also go to firms

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[2] New York State Tax and Finance Department, New York State Estate Tax Issues and Policy Options, Prepared for the New York State Tax Reform and Fairness Commission, July 2013, p. 4.

[3] Industrial Development Agencies were originally created to assist manufacturing businesses only but by the early 1990s IDA tax breaks were being given to the full range of businesses. In 1993, legislation was enacted placing reasonable limits on the granting of IDA tax breaks to retail establishments but more recently even those modest restrictions were allowed to lapse. Similarly, the state government's Investment Tax Credit, which was initially targeted to manufacturing and R&D facilities, has been expanded to include stock trading and movie making.

that are already paying greatly reduced property taxes because of threatened assessment challenges and/or IDA PILOT deals. Unless there are no budget restraints on the total value of the credits that could be taken, this will leave far less for actual small businesses without the ability to cut lucrative political deals.

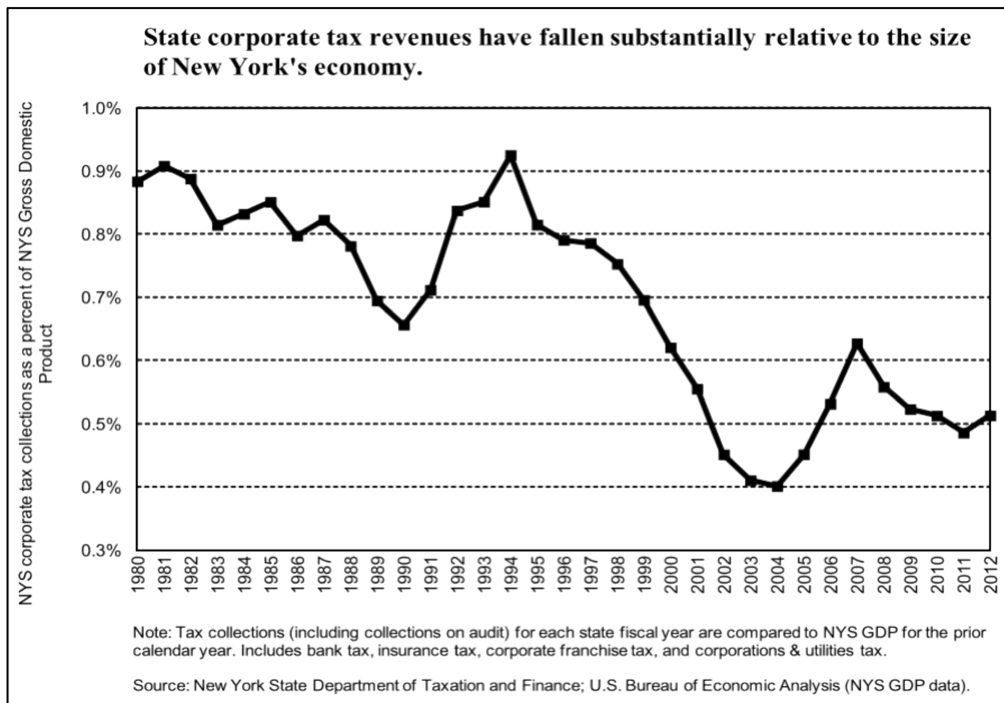
CORPORATE TAX CUTS – JUST BECAUSE: The Commission recommends a corporate income tax cut from 3.25% to 2.5 % for manufacturers and from 7.1% to 6.5% for other businesses. This proposal runs contrary to all evidence that corporate tax rate reductions simply do not have a job-creation effect. Moreover, New York has only recently reduced its manufacturing tax rate to 3.25%. Even though this rate has not been in effect long enough to determine if it has any positive economic impact, the commission is proposing to reduce it even further.

From 1984 to 1994, total corporate income tax collections (from the two corporation income taxes [Articles 9 and 9A], the insurance corporation tax, and the bank tax), represented 0.8 percent of New York State's Gross Domestic Product (GDP). Because of the continued existence of various tax loopholes, the ill-conceived expansion of business tax subsidies, and the adoption of changes such as Single Sales Factor, corporate income taxes were only 0.5 percent of state GDP in 2012. See chart below.

If the corporate tax share of state GDP were increased through loophole closing and by curbing unwise business tax expenditures and restored to the 0.8 percent that existed 25 years ago, the state would have over $3 billion more in revenues each year to invest in infrastructure and human capital and build a more sustainable and productive economy.

BIG BANKS GET AT LEAST A $346 MILLION TAX CUT THAT WILL GET BIGGER & BIGGER: The Commission recommendations include a "pig in a poke" corporate tax "reform" that is likely to reduce taxes substantially for the largest banks. The estimated net cost of $346 million in 2016-17 could very well be a gross under-estimation of the revenue that will be lost if this proposal is adopted. And the Commission includes no recommendations for offsetting the cost of this "reform" by eliminating ineffective business tax breaks, despite the compelling evidence presented by the Solomon/McCall commission and despite the increasing public support for reining in unnecessary tax breaks.

The Solomon Tax Commission did an exhaustive review of these business tax credits and found that they were ineffective and should be eliminated. (Marilyn M. Rubin and Donald J. Boyd, New York State Business Tax Credits: Analysis and Evaluation, A Report Prepared for the New York State Tax Reform and Fairness Commission, H. Carl McCall and Peter J. Solomon, co-chairpersons, November 2013. http://www.pjsolomon.com/news/media/2013-11-13-Tax_Incentive_Study_Final.pdf).



REAL CORPORATE TAX REFORM MISSING: New York's current "Swiss cheese" corporate tax structure is filled with holes – it would be smarter to eliminate corporate welfare and ensure a basic corporate minimum tax before we adopt more giveaways and rate reductions. If we wrung real billion-dollar savings out of our current seven-billion-dollar corporate welfare system, it would be possible to rationalize rates, eliminate loopholes and provide a saner, simpler tax system for all businesses. But the Pataki Commission did not do that – it just adds a new layer of giveaways and ignored the fact that state tax expenditures to big businesses have been growing at an astronomical rate, while yielding little or no results.

UTILITY TAX CUT COULD INCLUDE GOLDMAN SACHS: The Pataki Commission proposed eliminating the 18-a utility assessment for 'industrial' customers: but New Yorkers should watch out closely for the definition of "industrial" as negotiations over special tax breaks continue. For example, the Investment Tax Credit intended for manufacturing and research & development was later extended to Goldman Sachs and other broker/dealers by creating the Financial Services Investment Tax Credit, providing millions in unnecessary benefits to Wall Street firms. The Solomon Commission also proposed the elimination of this tax credit.

COMMISSION LACKS TRANSPARENCY AND ACCOUNTABILITY: The Pataki/McCall Commission met behind closed doors for two months to come up with their recommendations. They did not hold one public meeting or one public hearing. Since the Commission was created via press release rather than Executive Order it was not subject to the open meetings law. Creating tax policy behind closed doors never results in a good deal for the average New Yorker.