New York City Taxes—Trends, Impact and Priorities for Reform

Summary Version

Fiscal Policy Institute

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This is a summary version of FPI's report, ***New York City Taxes—Trends, Impact and Priorities for Reform***, released January 2015. This version includes the Executive Summary and 10 key charts. The full 85-page report is available at: http://fiscalpolicy.org/nyc-taxes-ripe-for-reform.

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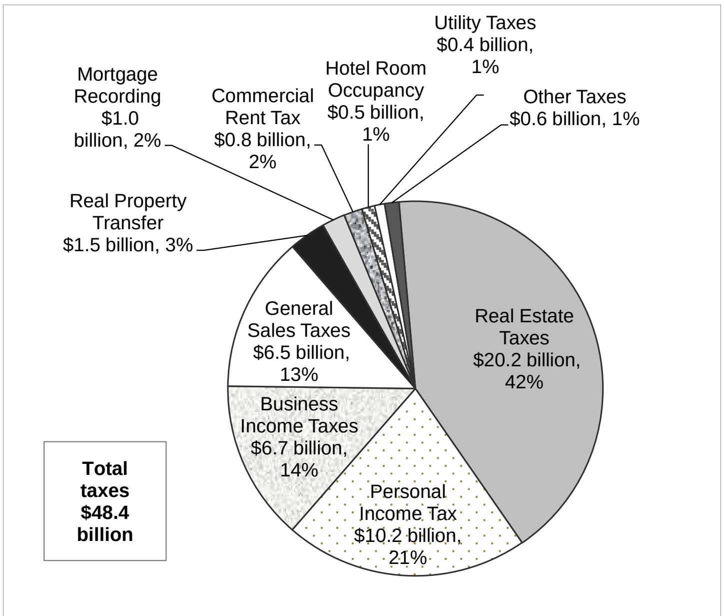
James Parrott, FPI Deputy Director and Chief Economist
January 2015

Executive Summary

The New York City government provides services to over 8 million residents, 4 million jobs (including 900,000 held by commuters), and some of the largest corporations in the world. At $77 billion in 2014, the New York City budget is larger than that of any other locality, and larger than all state governments except those of California, Texas, Florida, and New York State. The city is overwhelmingly reliant on raising its own taxes to fund these services and has become increasingly so in recent decades. Federal and state governments have restricted their contributions to the city budget, with federal aid declining and state aid operating under sharply capped increases. As recently as 1980 city taxes financed about half (53 percent) of the city budget. Today, that share has grown to nearly two-thirds (64 percent).

New York City has what may be the most diversified tax structure of any government in the United States, with a mixture of income taxes both on individuals and businesses, property and other real estate taxes, and sales tax. The mixture allows for a degree of stability through economic expansion and contraction. Taxes on income and real estate sales (property transfer and mortgage recording taxes) are highly cyclical, rising faster in a boom market and falling faster in a downturn. Balancing these, property, sales, and commercial rent taxes are more stable during downturns and account for nearly three-fifths of local taxes. This has served the city well in the context of a moderately growing economy.

CHART 1: NYC local tax collections, FY 2014



Source: Fiscal Policy Institute's Analysis of data from NYC Comptroller's Report for FY 2014, pp. 332-333.

The city's economic diversity and the sheer size of its economy adds resilience, helps the tax base weather cyclical ups and downs, and lessens its reliance on the fate of particular sectors or companies. New York City's $775 billion GDP makes its economy larger than that of 45 states.

Still, a high-quality tax system needs to serve multiple purposes and, given the dramatic changes in New York City's economy since the mid-1970s fiscal crisis, there have been remarkably few improvements in the city's tax structure over the past four decades. Building on principles first advanced by Adam Smith in *The Wealth of Nations*, the National Council of State Legislatures has articulated a set of six principles for a high-quality tax system, reflecting a changing political economy and evolving fiscal federalism: adequacy and reliability, economic neutrality and diversification, fairness, ease of administration and compliance, balancing tax burden and economic development concerns, and accountability to taxpayers.

New York City's tax system does well on the principles of adequacy and reliability, and on diversification, but it does not fare as well on the other criteria. Particularly worrisome in light of the pronounced polarization of income gains since the late 1970s, the city's overall household tax structure—property, income and sales taxes—lacks fairness. It is regressive and most changes over the past two decades have made it more so. The property tax system is characterized by undue opaqueness and complexity, and its features foster inequities between renters and homeowners, and across neighborhoods. The local tax structure also does a poor job of balancing tax burden and economic development concerns, shifting the commercial property tax burden to smaller businesses and from large businesses and developers through city actions giving tax breaks in the name of "economic development." The State's elimination of the commuter tax unjustifiably relieved non-resident workers of a portion of the city tax burden, shifting it to others. The public is often at a loss to know who to hold accountable for these policies: Albany action is needed to change almost any aspect of the city's tax system, letting local elected officials off the hook, and subjecting reforms to a state legislative process in which many of the players are elected from districts far from New York City.

This report assesses the structure of New York City's tax system, examines trends in city taxes and tax exemptions and expenditures, and reviews the history of tax policy changes over the past four decades. Along the way, it considers the relationship of local taxes to the state's taxes, and how the state divides up financing responsibility for financing public services. It explores different considerations in assessing the city's tax burden relative to other cities and other parts of New York State, and the much-debated impact of taxes on the mobility of high-income households. Finally, the report identifies the most-pressing areas in need of tax reform and discusses several reform proposals.

Key Findings

In New York State, localities—including New York City—bear a higher share of government costs than in other states. Most non-federal government expenses around the country are funded through a combination of state and local taxes. On average across all states, local taxes represent about 40 percent of combined state and local taxes. But in New York, local governments bear more than half (53 percent) of all state and local taxes, the third-highest share among all fifty states. In part, this is due to the Empire State's requirement that local governments bear a higher portion of the non-federal share of Medicaid costs and public assistance. New York State's smaller share of these jointly-funded expenditures accounts for over half of the tax effort differential between New York City and large cities in other states, according to the city's Independent Budget Office (IBO).

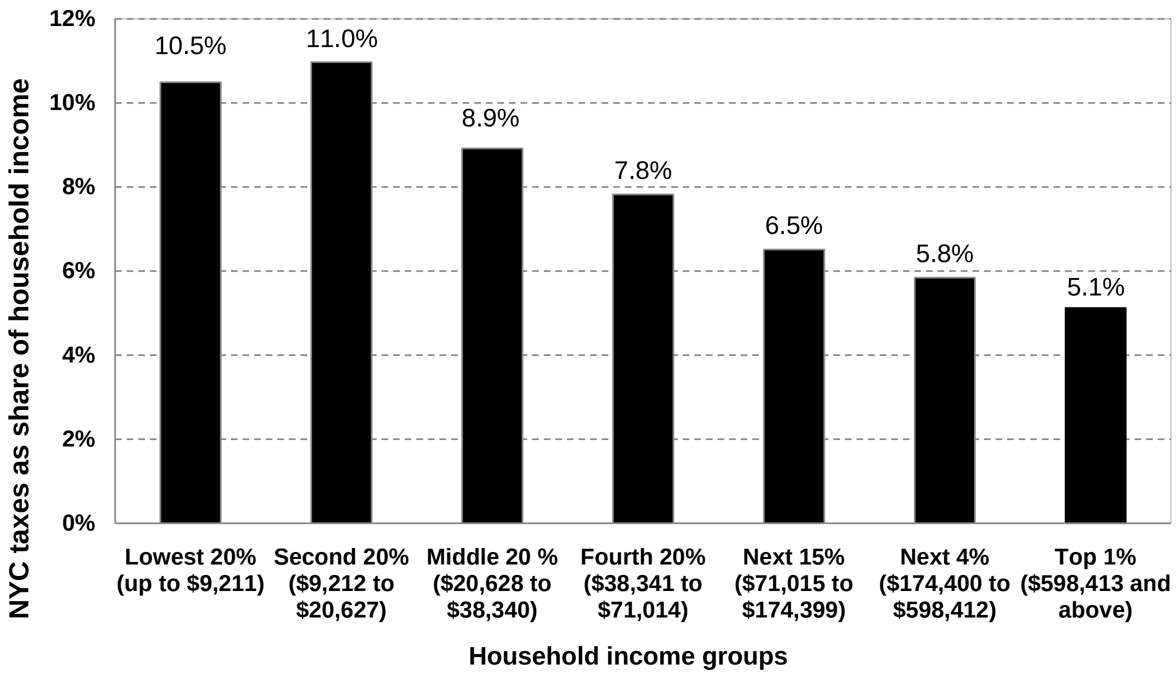
New York State is also underfunding New York City schools. After a decades-long legal battle over the state responsibility for school financing that ended in 2007, New York State finally agreed to a funding formula in response to the State's highest court's finding in the Campaign for Fiscal Equity lawsuit. The state, however, has been very slow to honor the terms of that agreement, leading the City to substantially increase school funding out of local taxes.

Together with the State elimination of the city's commuter tax, these state actions on Medicaid and school aid have shifted about $10 billion in funding responsibility onto the City, close to one-fifth of total City taxes. (The State's 2014 commitment to fund the expansion of universal pre-kindergarten and after-school programs is the rare departure from this pattern.)

In relation to personal income—granted, an imprecise measure since it excludes the earnings of out-of-state commuters, corporate profits, and capital gains income—New York's overall state and local tax burden rose marginally by two percent from 1995 to 2012. Over this period, both the state tax burden and the local tax burden outside of the city stayed relatively flat or declined, while the city's local tax burden increased by eight percent. Though property taxes are a legitimate concern around the state, it may come as a surprise that, between 1995 and 2012, local property taxes elsewhere in the state declined by four percent relative to income.

On a household level, both the combined New York state and local tax burden, and the New York City tax burden are regressive in their impact, with low- and middle-income households paying a higher share of their income in state and local taxes than high-income households. In 2015, the richest one percent paid 8.1 percent of their income in New York state and local taxes (after allowing for federal deductibility), while those in the middle paid 12.0 percent. In New York City, the top one percent paid 5.1 percent in local property, sales and income taxes in 2011, while those in the middle paid 8.9 percent, and those at the bottom paid 10 percent.

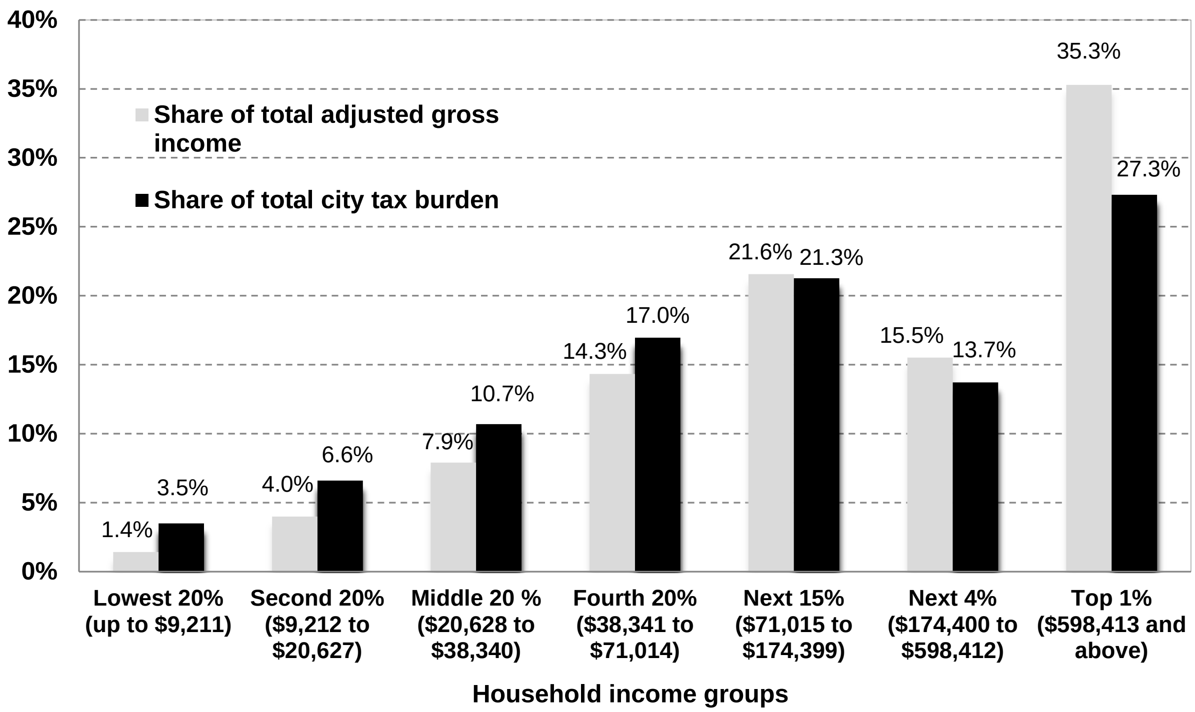
CHART 2: NYC has a regressive local tax burden (income, sales, and property tax), with low- and middle-income households in 2011 paying a higher share of their incomes in NYC taxes than did the wealthiest 5%.



Source: Fiscal Policy Institute estimates based on NYS and NYC tax data for NYC residents, 2011. Includes Unincorporated Business Tax

Looked at another way, the top one percent in the city—tax filers with incomes over $600,000—received 35 percent of all income in 2011 but paid only 27 percent of local taxes. The first four income quintiles—the "bottom 80 percent" with incomes under $71,000—paid a greater share of city taxes than their share of income. This disparity reflects the regressivity of sales and property taxes and the fact that rental properties (lower-income households are much more likely to rent) bear a much higher effective property tax than do owner-occupied housing. (The analysis underlying these figures includes the City's unincorporated business tax.)

CHART 3: While the city's income tax is mildly progressive, residential property and sales taxes are regressive, resulting in the top 5% paying a smaller share of NYC taxes in 2011 than their share of all income.



Source: Fiscal Policy Institute estimates based on NYS and NYC tax data for NYC residents, 2011. Includes Unincorporated Business Tax.

In recent years, much attention has been given to the question of whether high-income households will move away if New York City raises their taxes. Asked to look at this issue by the Solomon-McCall tax reform commission appointed by Governor Cuomo, the state's tax policy staff concluded: "[Research on the impacts of taxes on the migration behavior] generally show that taxes have relatively little impact on cross-state migration." State tax policy expert Michael Mazerov noted: "The vast majority of academic research using sophisticated statistical techniques concludes that differences in state tax systems and levels do not have a significant impact on interstate migration."

Rather than showing an exodus of wealthy households, tax data show that the number of New York City households with incomes of $1 million or more rose much faster between 2000 and 2011 than in the U.S. as a whole. Also, the total income of those high-earners rose much faster in New York City than in the U.S. overall over the decade. Wealthy residents seem to see taxes as akin to high real estate prices: the cost of being here.

Looking at the city's tax structure, the biggest shift since 1980 has been the increase in the personal income tax share relative to the property tax share. The property tax is still the single largest local tax, but its 42 percent share in 2014 is less than its 46 percent share in 1980. The personal income tax share rose from less than 13 percent to 21 percent over that period. Business income taxes have hovered around a 14 percent share of city taxes since the mid-1990s, despite the growth in corporate profits. The share accounted for by the real property transfer and mortgage recording taxes jumped from one to five percent. As is the case nationwide, the general sales tax has declined in importance as a local tax over the past three decades as consumer spending has shifted from goods, more of which are taxed, to services, fewer of which are subject to sales taxes.

CHART 4: New York City major taxes: amounts and shares

	1980	1990	2000	2010	2014
Amounts ($ millions)					
Real property	$3,196	$6,543	$7,850	$16,369	$20,202
Personal income	$879	$2,538	$5,365	$7,593	$10,174
General sales	$1,142	$2,431	$3,526	$5,076	$6,509
Business income	$821	$1,675	$3,276	$5,179	$6,674
Real-estate related *	$70	$370	$890	$983	$2,491
Commercial rent	$219	$685	$375	$618	$771
Other taxes (hotel, utility, auto-related, other)	$632	$774	$947	$1,363	$1,555
TOTAL NYC TAXES	$6,960	$15,015	$22,229	$37,201	$48,375
Share of NYC taxes					
Real property	45.9%	43.6%	35.3%	44.0%	41.8%
Personal income	12.6%	16.9%	24.1%	20.4%	21.0%
General sales	16.4%	16.2%	15.9%	13.6%	13.5%
Business income	11.8%	11.2%	14.7%	13.9%	13.8%
Real-estate related *	1.0%	2.5%	4.0%	2.6%	5.1%
Commercial rent	3.1%	4.6%	1.7%	1.7%	1.6%
Other taxes (hotel, utility, auto-related, other)	9.1%	5.2%	4.3%	3.7%	3.2%
TOTAL NYC TAXES	100.0%	100.0%	100.0%	100.0%	100.0%

* Real estate-related includes mortgage recording and real property transfer taxes.

Source: Comprehensive Annual Financial Reports of the Comptroller, 1980-2013 compiled by the NYC Independent Budget Office.

With the exception of the property tax and the hotel tax, there have been no major tax increases since the mid-1970s. Business taxes have been reduced repeatedly. Since 1996, carried interest, a form of income received by investment funds managers, has been exempt from business taxation. Since 1988, the capital tax base cap on the corporate tax has benefited only a handful of large companies.

While the personal income tax share of city taxes is higher than it was in 1980 or 1990, it has remained around 20-21 percent over the past 20 years, with surges to 25 percent during peak years for capital gains and Wall Street bonuses (like 2001 and 2008). This relative stability is

CHART 5: Main areas of significant NYC tax policy changes since 1977, by mayoral administration

Koch Administration, 1978-1989

- Established several business development subsidy programs, including two of the most costly programs: ICIP, and the cap on the business and investment capital base alternative for calculating business income tax liability.
- Modest reduction in business income tax rates.
- Granted $200 million subsidy package to Chase Manhattan Bank in 1989 to locate in Metro Tech, Brooklyn, setting a precedent for very costly discretionary subsidy deals for other large corporations.

Dinkins Administration, 1990-1993

- Raised personal income tax rates in a mildly progressive manner with two surcharges, with a portion dedicated to policing.
- Modestly raised property tax rate, with a portion dedicated to policing.
- Granted several costly retention deals to large financial service and media firms.

Giuliani Administration, 1994-2001

- Several business tax reductions, especially for the Commercial Rent Tax and the Unincorporated Business Tax, including exempting carried interest from taxation under the UBT.
- City Council initiated two major tax reductions: eliminating the 12.5% personal income tax surcharge and establishing the co-op/condo property tax abatement.
- NYS eliminated the non-resident earnings ("commuter") tax.
- Continued granting several costly retention deals, including one for the New York Stock Exchange.

Bloomberg Administration, 2002-2013

- Increased property tax rates in 2003 by 18.49% to fill the revenue hole made by several tax reductions under the previous administration, and when economy recovered, provided temporary homeowner rebate and 7% rate reduction. However, did not attempt to reform property tax system despite mounting inequities.
- Missed opportunities to reform ICIP and 421-a tax tax breaks—the two most costly NYC tax breaks.
- Increased regressive sales tax rate by 0.5%, but did establish modest low-income personal income tax credits (EITC and child care credit).
- By limiting the STAR rate cut and limiting itemized deductions in 2010, the State modestly increased income taxes on high-income households.
- While fewer individual large retention deals negotiated, approved generous subsidy deals for Yankees and Mets costing $1 billion-plus over the life of those agreements. Also established massive property tax breaks in the Hudson Yards district that have the potential to cost the City a billion dollars or more.

Sources: NYC Office of Management and Budget (OMB), *Tax Revenue Documentation, Financial Plan FYs 2013-2017*, July 2014; NYC OMB *Forecast Documentation*, April 1995, April 1998, and November 2014.

surprising: if the local income tax were more progressive its share would be rising along with the continued concentration of income. From 1995 to 2012, the share of total income going to the richest one percent in the city rose from a very high level of 20 percent to a dizzying 39 percent.

At 3.88 percent, the current top city personal income tax rate is about one-tenth *lower* than its 1977 rate of 4.3 percent. The income tax structure is more compressed than it used to be, making it considerably less progressive. Currently, there are five brackets separated by less than one percentage point of tax liability, whereas from 1976 to 1986, there were 14 brackets and a 3.4 percentage point spread. Moreover, about 200,000 low-income households pay income tax to the City although they have no state or federal income tax liability.

In response to a 1975 court decision finding that property tax assessment practices resulted in an uneven distribution of the property tax burden, the State Legislature partially revamped the City's property tax system and added certain features to protect homeowners. However, by the mid-1980s, economist Matthew Drennan voiced a perspective repeated by many observers since then when he wrote, "Rather than reforming the property tax, the [1981] State law has made progress towards reform more difficult." Inequities have mounted over the years. Despite repeated calls for remedial action from actors representing different interests over the last 30 years, no meaningful, politically-viable reform proposal has emerged from either City Hall or Albany.

In the City Council's response to the Mayor's preliminary FY 2015 Executive Budget, a case was made for property tax reform: "Numerous studies have pointed out that the current system is rife with inequalities with properties of similar value and use having very different tax bills. The system is also inordinately complex, making it difficult to administer and nearly impossible for taxpayers to understand."

Other than an 18 percent rate increase in 2002, the one major property tax change since the early 1980s—the co-op/condo partial tax abatement—has narrowed inequities between condominiums and co-ops compared to owners of 1-3-family homes, but it further widened them with respect to rental properties.

Since mid-20th century, a large share of real property in New York City has been exempt from property taxes, including government properties and property owned by one form or another of non-profit institutions, such as religious organizations or private colleges and universities. However, in recent years, properties owned by for-profit entities have increasingly benefited from property tax exemptions intended to spur investment in housing or commercial expansion.

Moreover, the largest property tax break intended to promote housing development—421-a—has grown by leaps and bounds since 2000 although it has long been desperately in need of reform. When 421-a was established in 1971, its purpose was mainly to foster housing development but with no emphasis on affordability, an oversight that badly needs correcting. The 421-a share of all exemptions has jumped from 5.5 percent to 21 percent just since 2000, and the share of tax breaks provided under the Industrial and Commercial Incentive Program (ICIP) program rose from 8 to 13 percent. The city's housing needs have changed markedly since 421-a was established, and the ICIP program and its successor, the Industrial and

Commercial Abatement Program, are widely viewed as providing a tax break windfall for investments that would have taken place anyway.

CHART 6: Rise in Private Property Tax Exemptions

share of NYC property tax base that is taxable or tax-exempt *

	1950	1980	2000	2009	2014
Taxable property	73.8%	57.0%	54.9%	58.3%	59.8%
Tax-exempt government property	22.2%	36.1%	33.0%	27.4%	25.7%
Tax-exempt private property	4.0%	6.9%	12.1%	14.3%	14.4%
TOTAL NYC real property	100.0%	100.0%	100.0%	100.0%	100.0%

* Note: Exemptions here do not include property tax abatements; in 2014, abatements were valued at $733 million, of which the largest is the co-op/condo abatement ($412 million).

Source: New York City Dept. of Finance, *Annual Report on the New York City Real Property Tax, FY 2000, 2009, 2014*.

CHART 7: Private Property Tax Exemptions, FY 2014

	Tax value ($ millions)
Tax value of all exempt private property	**$5,136.1**
Institutional properties	**$2,041.5**
Religious institutions	$630.4
Medical care	$522.0
Educational facilities	$452.9
Charitable institutions	$218.4
Cemeteries and other	$111.2
Cultural institutions	$105.7
Residential	**$2,018.9**
New multiple dwellings (421-a)	$1,073.3
Limited profit housing companies (Mitchell-Lama)	$287.7
J-51 exemption	$171.0
Redevelopment companies	$126.7
420-c low-income housing	$112.6
Housing development fund companies	$71.8
Other	$175.8
Indiv. Assistance (STAR, Senior Citizens, Veterans, etc.)	**$374.2**
Commercial/Industrial	**$701.4**
Industrial & commerical incentive program	$672.7
Madison Square Garden*	$17.3
Other commercial/industrial	$11.5

* Note: The Independent Budget Office reports that the FY 2015 Madison Square Garden property tax exemption rose to $44 million as a result of major renovations. New York City Independent Budget Office, *Budget Options 2014* , November 2014.

Source: NYC Dept. of Finance, *Annual Report on the NYC Real Property Tax, FY 2014* .

CHART 8: New York City Private Property Tax Exemptions

Shares of all exempt private property	**2000**	**2014**
Exempt value--private property	100.0%	100.0%
Institutional properties	56.3%	39.7%
Religious institutions	18.2%	12.3%
Medical care	16.9%	10.2%
Educational facilities	10.6%	8.8%
Charitable institutions	4.6%	4.3%
Cultural institutions	2.8%	2.2%
Cemeteries and other	3.3%	2.1%
Residential	28.6%	39.3%
New multiple dwellings (421-a)	5.5%	20.9%
Limited profit housing companies (Mitchell-Lama)	11.9%	5.6%
J-51 exemption	2.9%	3.3%
Redevelopment companies	2.9%	2.5%
Housing development fund companies	2.0%	1.4%
Other	3.4%	5.6%
Indiv. Assistance (STAR, Senior Citizens, Veterans, etc.)	5.9%	7.3%
Commercial/Industrial	9.2%	13.7%
Industrial & commerical incentive program	7.8%	13.1%
Madison Square Garden	0.5%	0.3%
Other commercial/industrial	1.0%	0.2%

Source: NYC Dept. of Finance, A*nnual Report on the NYC Real Property Tax, FY 2000, 2014*.

The term “tax expenditures” includes exemptions, exclusions, abatements, credits or other benefits allowed against a range of city taxes, and that result from a specific City or State action. It does not include foregone taxes from a range of institutional properties (such as religious, medical, educational and charitable institutions) that have historically been exempted from the property tax. The Finance Department’s 2014 annual tax expenditure report identifies a total of $7.1 billion in property and non-property tax exemptions, abatements and credits—$3.4 billion is housing-related, $3 billion is business-related, and roughly $800 million benefits households.

Most tax expenditures intended to induce business investment or employment or to retain businesses and jobs were put in place in the 1980s when the city’s economy was recovering from the 1970s out-migration of people and businesses. Routinely, these breaks have been extended without a thorough evaluation of their value. Business tax expenditures have more than tripled in value since 2001, increasing to nearly $3 billion annually, and have grown more than twice as fast as total city tax collections.

CHART 9: NYC Business Tax Expenditures, FY 2001 and 2014

($ millions)

	FY 2001	FY 2014	% change
Total NYC Business Tax Expenditures	**$918**	**$2,912**	**217%**
Real Property Tax Expenditures	**$434**	**$1,359**	**213%**
Industrial & Commercial Incentive Program (and new ICAP program)	$178	$680	283%
Other Commercial & Industrial Exemptions	$39	$42	10%
Industrial Development Agency	$66	$241	265%
Economic Development Corporation	$4	$102	2515%
Urban Development Corporation -- Commercial	$104	$200	93%
Battery Park City Authority -- Commercial	$44	$93	112%
	TY 1998	*TY 2010*	
Business Income Tax Expenditures	**$430**	**$1,055**	**145%**
Business and Investment Capital Tax Limitation	$32	$319	897%
Insurance Corporation Non-Taxation	$193	$394	104%
Single Sales Factor	$0	$83	n.m.
Commercial Revitalization Program	$11	$38	245%
Relocation & Employment Assistance Program	$5	$28	460%
Energy Cost Savings Program Credit	$29	$26	-10%
Other (Relocation & Employment Assistance, Film Production, etc.)	$160	$167	4%
Sales Tax Expenditures	*TY 1998*	*TY 2010*	
Fuel sold to airlines	**$30**	**$153**	**410%**
Personal Income Tax Expenditures	*TY 1997*	*TY 2011*	
Uninc. Business Tax (UBT) Credit on NYC Personal Income Tax	**$24**	**$130**	**442%**
		FY 2013	
NYC Industrial Dev. Agency Non-Property Tax Expenditures	**n.a.**	**$16**	n.m.
Exemption for Carried Interest, NYC UBT	**n.a.**	**$200**	n.m.
NYC Total Tax Collections, including audits	**$23,248**	**$47,455**	**104%**

Note: The time period for percent change varies for non-property taxes and is for the time indicated by the tax years for the data cited.

Sources: Unless noted separately, data are from NYC Finance Department, *Annual Report on Tax Expenditures, FY 2001 and FY 2014* ; tax collections from NYC Comptroller, *Comprehensive Annual Financial Reports, FY 2001 and FY 2014* ; IDA non-property tax expenditures from NYC Economic Development Corp., *Annual Investments Projects Report Pursuant to Local Law 62, FY 2013, Vol. 1* , January 7, 2014; carried interest estimate from NYC Independent Budget Office, *Budget Options 2014* , Nov. 2014.

In a similar vein, with no evidence of an economic justification, a major expansion of as-of-right property tax breaks for large commercial developments was launched in 2005 for the re-zoned Hudson Yards district. The magnitude of the Hudson Yards tax breaks only became widely understood when JPMorgan Chase sought an additional subsidy of $1 billion in October 2014 when considering constructing a new headquarters in the Hudson Yards district. In rebuffing the bank’s request, the de Blasio administration pointed out that the bank would already get about $600 million in tax breaks under the as-of-right Hudson Yards program established by Mayor Bloomberg.

Tax Reform Considerations

Property tax: There is a critical need to change the provisions of the State real property tax law that establish ceilings on increases in Class 1 (1-3 family homes) assessments and that require the use of an arcane rental property treatment for assessing co-ops and condos. Problems related to adjusting tax shares among different property categories should also be addressed. The main goal should be to equalize effective tax rates for all residential properties and neighborhoods. Since there would be short-term winners and losers, transitional assessments over an extended period would be appropriate to moderate necessary increases. Special provisions would be needed to ensure that renters benefitted from property tax reductions affecting their buildings. These changes would further both horizontal equity (among households at comparable income levels) and vertical equity (among households at different income levels) and go a long way in promoting administrative efficiency and accountability while reducing complexity.

CHART 10: Net effective tax rates for selected property types, 1984 - 2007

per $100 of market value

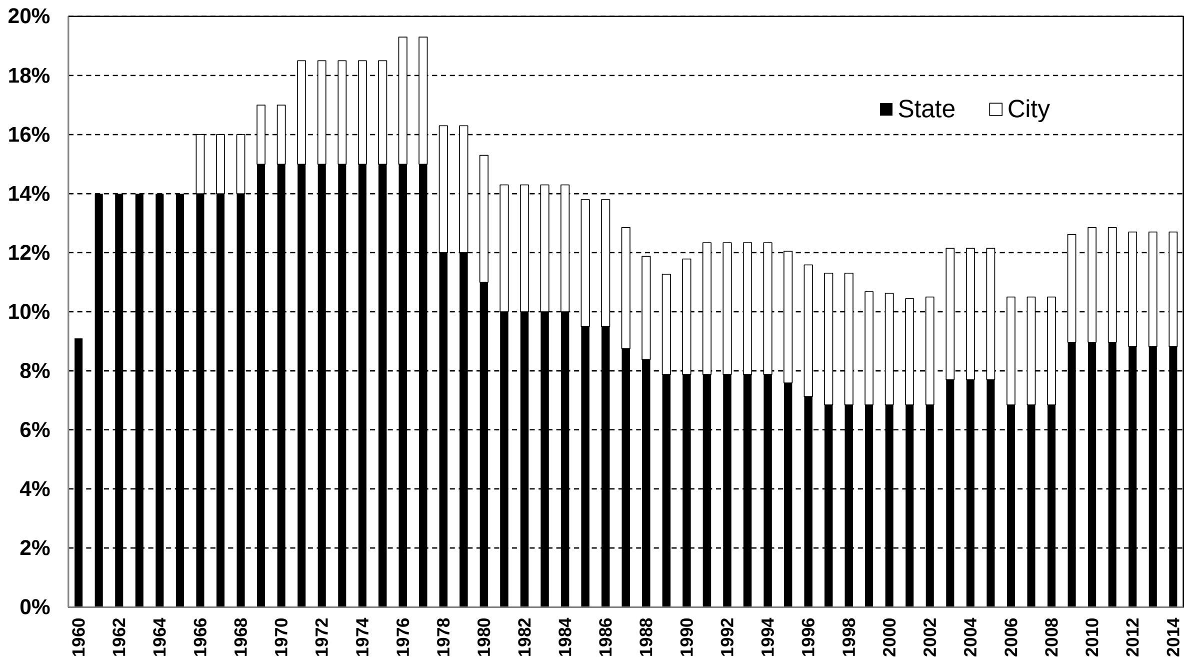
Fiscal year	1-3 Family	Co-ops	Condos	Walkups	Elevators	2A/2B	Class 3	Class 4
1984	1.32	0.96	0.94	4.54	3.64	2.22	4.58	4.33
1987	0.88	0.97	0.79	3.22	2.60	1.63	4.55	3.24
1997	0.77	1.86	1.63	4.03	3.38	2.12	3.48	3.81
2007	0.46	0.68	0.68	4.21	3.72	0.78	5.15	3.56

Source: NYC Independent Budget Office, *Twenty-Five Years After S7000A: How Property Tax Burdens Have Shifted in New York City* (December 2006), Table 2.

The 421-a property tax exemption has become the City's costliest tax break at $1.1 billion, and it is of questionable value, particularly since in Manhattan there are more non-primary resident owners benefiting from 421-a tax breaks than primary residents. It expires in June 2015 and needs to be revamped to concentrate benefits on the construction of truly affordable housing units, helping the City address its ambitious affordable housing goal.

Personal income tax: The main priority should be to enhance progressivity. This can be achieved through a combination of: changing the rate structure to increase the number of brackets below the current top rate; increasing the City's Earned Income Tax Credit (EITC); extending the EITC to childless couples and workers ages 21-24 and 65-66; and possibly also enhancing the city's child and dependent care and household credits. The combined city and state top income tax rates are already relatively high so there is a limit on raising the City's top rate. (However, this could change if the State does not continue the current 8.82 percent top rate when it expires at the end of 2017.)

CHART 11: Top marginal tax rates on personal income, New York State & New York City, 1960-2014



Notes: New York City had no PIT before 1966. The state had higher top rates on *unearned* income from 1978-1986; these are not included here.

Sources: State: NY State Division of the Budget, *FY 2015 Economic & Revenue Outlook*, Table 1; NY State Dept. of Taxation & Finance, *New York State Tax Sourcebook* (April 2005), Table 37. City: New York City Office of Management & Budget, *Tax Revenue Forecasting Documentation, Fincancial Plan Fiscal*

The current 23 percent credit on the personal income tax for unincorporated business tax liability should be revisited since most of the benefits go to households with adjusted gross incomes of $1 million or more. These households receive about $100 million from this credit, an amount that could pay for a doubling of the City's current 5 percent EITC. Before raising the top tax rate, consideration should be given to adding a rate benefit recapture provision as used at the state level. Any of these changes would enhance the fairness of the City's overall tax structure.

Taxing commuters: The State should redress the politically-dubious 1999 repeal of the City's very modest non-resident earnings tax. There are approximately 900,000 commuters working in the city; they account for 35 percent of all New York City earnings, yet, except for those paying the unincorporated business tax, they currently do not help fund the public services on which they and their employers rely. The IBO estimates that restoration of the commuter tax at the same tax rates as before would generate $860 million annually. Restoration advances fairness and accountability.

Taxing high-value pied-à-terre residences: There is a growing number of ultra-luxury residences in New York City that are being purchased by people who are not full-time residents, and, as such, are not paying the City's personal income tax. Because some of these high-valued units benefit from tax breaks or the arcane method for assessing condominium properties, the effective property tax rate on many of these units likely is low. A modest, graduated pied-à-terre tax on units valued above $5 million could generate $250 million or more per year. A pied-à-terre tax advances fairness and accountability.

Business taxes: While tax simplification and administration would be furthered by aligning the City's corporate and bank income taxes with the recent State corporate tax reform, there is legitimate concern regarding the adverse revenue impacts. To help offset some of the potential tax loss, the City could close corporate tax loopholes, such as the $1 million cap on tax liability under the capital tax base measure, one of the three alternative methods corporations must use to calculate tax liability. For 2010, the Finance Department estimates that 24 corporations received a combined benefit of $319 million under this provision.

Further, additional revenues likely would be needed from broadening the corporate tax base by implementing full unitary combined reporting and eliminating the separate treatment of subsidiary capital and income. Finally, as part of the measures conforming to the State's corporate tax reform, the City should modify how "nexus" is determined in order to fairly tax the income of companies conducting business activity within the city, and it should significantly raise the current $5,000 fixed dollar minimum tax for large corporations.

Business tax expenditures: In addition to the capital tax base limitation, other business tax breaks need to be revisited to determine their economic value and adjusted as needed. At the top of this list is the Industrial and Commercial Abatement Program (ICAP) that is subsidizing hotel and other commercial developments, many of which likely would proceed even in the absence of ICAP benefits.

The City also should assess the need for property tax and other subsidies in Hudson Yards. Since the district has clearly demonstrated its commercial viability, there is absolutely no need for the City to provide tax breaks. The sooner it stops discounting taxes, the sooner the City will be able to repay the bonds sold to build the #7 subway extension. Most business tax breaks go disproportionately to large, wealthy corporations.

The City's current carried interest exemption under the unincorporated business tax is nothing more than a tax loophole introduced and maintained in order to minimize taxation on often well-connected investment funds. Eliminating the exemption would net the City approximately $200 million annually and promote fairness among payers of the unincorporated business tax.

These changes will help level the economic development playing field for smaller businesses and improve accountability in the eyes of the average taxpayer. Resources could also be freed up to fund more promising economic development interventions.

Real estate related taxes: The City's mortgage recording tax (MRT) applies to all types of residential real estate except co-ops. Eliminating this exception would generate an estimated $98 million annually in 2016, according to the IBO, and $50 million more if the exception were eliminated for the State MRT, of which the City receives a portion. Another proposal would be to add a new bracket to the real property transfer tax (RPTT) for high-value residential properties. The top City RPTT rate of 1.425 percent now applies to transactions over $500,000. Establishing a 1.925 percent bracket for transactions of $5 million or more could yield about $39 million in 2016, according to the IBO. The main value of such changes is to generate resources to help the City address its affordable housing priorities.

In addition to these specific measures, two additional changes are advisable. First: The City's Executive branch should develop the capacity to analyze the distributional impact of local taxes across income classes, to guide its efforts as it approaches tax reform or entertains any tax proposals. An analytical capacity would help target tax changes to enhance progressivity and avoid unintended consequences in an era when income polarization takes center stage.

Conclusion

New York City's tax system is diverse and has served the city well in the context of a moderately growing economy. However, given the vastly improved attractiveness of the city to real estate development and to a range of dynamic economic sectors, there is a pressing need to re-think several tax breaks initially intended to foster business and housing development. Moreover, considering the persistence of serious property tax inequities and a regressive overall local tax burden in the context of a pronounced polarization of income since 1980s, it is important for the City to reform its property and personal income tax systems to increase fairness.

The State legislature and governor should give New York City greater authority to make adjustments to existing taxes within a defined range, and to periodically extend or modify existing tax policies and programs. The State constitution allows the legislature to enact laws "which delegate the taxing power [provided such laws] shall specify the types of taxes which may be imposed thereunder and provide for their review."[1] The State already allows cities and counties the option of whether to conform to certain sales tax exemptions and provides New York City unique authorization to impose its sales tax on a broader range of services than the State or other local governments.[2]

[1] New York State Constitution, Article XVI, section 1. Also, see Erin Adele Scharff, "Taxes as Regulatory Tools: An Argument for Expanding New York City's Taxing Authority," *New York University Law Review*, Vol. 86, 1556-1589.
[2] New York State Department of Taxation and Finance, Office of Tax Policy Analysis, *An Evaluation of New York State's Sales and Compensating Use Tax*, Prepared for the New York State Tax Reform and Fairness Commission, June 2013, C-5.

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www.fiscalpolicy.org

One Lear Jet Lane • Latham, NY 12110 • 518-786-3156
11 Park Place, Suite 701 • New York, NY 10007 • 212-721-5624