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New report
http://fiscalpolicy.org/nyc-taxes-ripe-for-reform (live at 12:01am on January 13, 2015)

New FPI report: New York City Taxes Ripe for Reform
Tax structure regressive and major tax breaks should be fixed or scrapped

New York—The City of New York taxes its wealthiest residents much less than middle- and low-income residents, and state and local officials should fix three major City tax breaks that expire this year, according to a new report from the Fiscal Policy Institute (FPI). In a sweeping report that reviews decades of tax changes and trends, FPI pinpoints inequities, tallies the cost of broken tax breaks, and urges tax reforms that reflect today's economy and current challenges.

The three largest New York City tax breaks that together account for $2.2 billion in foregone taxes expire this year and the Mayor, the City Council, the State Legislature, and the Governor will need to decide whether to fix flaws or allow millions more in taxpayer dollars to be squandered. These tax breaks include: 421-a (which provides hefty tax breaks to luxury housing, expiring June 15); the Industrial and Commercial Abatement Program or ICAP (which provides tax breaks for real estate investments that likely would happen anyway, expiring March 1); and the Co-op/Condo Property Tax Abatement (which poorly targets tax breaks in a way that benefits high-income neighborhoods while shifting the tax burden to rental properties, expiring June 20).

In addition, given worsening income disparities and stagnant incomes for most families, lawmakers can no longer ignore glaring inequities in the City taxes that most directly affect the average household—residential property, personal income and sales taxes. The report estimates that the wealthiest 1% of households in the City pay 5.1% of their income in City property, income and sales taxes while the 80% of households with middle- and low-incomes pay 9-11% of their income in taxes, about twice as much as the wealthiest.

"There's more to 'tax reform' than cutting taxes," said James Parrott FPI's Deputy Director and Chief Economist and the report's author. "The City really needs to take a close look at tax breaks to make sure it's getting a good bang for the buck, and there is no reason that the poor and the middle class should be paying more of their income in taxes than the richest City residents," Parrott continued.

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"This is not about raising taxes, but about fixing the City's tax structure and making sense out of a plethora of business tax breaks whose cost is rising twice as fast as the tax base and that need to be seriously re-thought," said Ron Deutsch, FPI's Interim Executive Director.

Among the report's highlights:

- With federal aid declining and state aid operating under sharply capped increases, local taxes fund a growing share of the City budget, 64% today, up from 53% in 1980.

- New York State taxes fund one of the smallest shares of combined state and local expenses in the country; this fact and actions by the state to repeal the commuter tax and short-change the City on school aid have meant that the state has shifted about $10 billion in funding responsibility to the City, close to one-fifth of all taxes.

- The biggest shift in the City's tax structure since 1980 has been the increase in the personal income tax share relative to the property tax share—personal income taxes were 13% of the total in 1980 but 21% today; the property tax share, still the largest, dropped from 46 to 42%.

- It is surprising that the personal income tax share of city taxes has remained around 20-21% over the past 20 years, given the continued concentration of income. From 1995 to 2012, the share of total income going to the richest 1% in the city nearly doubled from 20% to 39%.

- In 2011, the top 1% of City tax filers, those with incomes over $600,000, had 35% of all income but paid only 27% of local taxes. At the same time, the "bottom 80 percent"--those with incomes under $71,000—paid a greater share of City taxes than their share of income. This disparity reflects the fact that the regressivity of the City sales and property taxes overwhelms the City's slightly progressive personal income tax.

- The City's income tax structure is more compressed than it used to be, making it considerably less progressive. Currently, there are 5 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. At 3.88%, the current top City personal income tax rate is about one-tenth *lower* than its 1977 rate of 4.3%.

- About 200,000 low-income households pay income tax to the City although they have no state or federal income tax liability.

- The City's total tax expenditures—tax breaks mainly given to businesses to spur jobs and investment and to developers to subsidize housing—were $7.1 billion in 2014: $3.4 billion is housing-related, $3 billion is business-related, and roughly $800 million benefits households.

- 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.

- Most business tax expenditures 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 any evaluation of their value. Their $3 billion cost has more than tripled since 2001, and has grown more than twice as fast as total City tax collections.

The report makes these tax reform recommendations:

- Reduce serious inequities in the residential property tax system caused by assessment caps and by the requirement that co-ops and condos be assessed as if they were rental properties. If changes equalize effective tax rates for residential properties and neighborhoods, there will be no need for the co-op/condo tax abatement.

- The 421-a property tax exemption should be re-vamped to concentrate benefits on the construction of truly affordable housing units.

- The City's personal income tax should be made more progressive by increasing the number of brackets below the current top rate, increasing the Earned Income Tax Credit and extending it to young workers, 21-24, older workers, 65-66, and to childless couples. Before raising the top tax rate, the City should add a rate benefit recapture provision like the State's.

- The 23 percent credit on the personal income tax for unincorporated business tax liability that goes mostly to millionaire households should be reduced to help fund low-income tax relief.

- The State should redress the politically-dubious 1999 repeal of the City's modest commuter tax; there are 900,000 commuters who account for 35% of all New York City earnings.

- Because a growing number of non-primary residents own high-value apartments and townhouses, but do not pay City income tax or much in property taxes, the City should institute a pied-à-terre tax on residential properties valued above $5 million.

- The City should update its business taxes to conform to state tax changes that broaden the base and levels the playing field among large businesses, and that is revenue neutral or better by raising the capital base tax to $10 million and increasing the minimum tax from $5,000 to $200,000. The City should keep the corporate tax rate at 8.85%, and if there are sufficient offsetting revenues, reduce the tax rate for small businesses and manufacturers.

- Beginning with restricting the Industrial and Commercial Abatement Program that now subsidizes many developments that would take place even without tax breaks, the City should evaluate its various business tax breaks to focus benefits where truly needed, freeing up resources that could fund more promising economic development interventions.

- The City should close the carried interest exemption loophole under the unincorporated business tax, saving $200 million a year and promoting fairness among business taxpayers.

- The City should re-assess the need for costly property tax and other subsidies in Hudson Yards since the district has clearly demonstrated its commercial viability

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In addition to these specific measures, 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.

At present, State action is needed to make almost any change in New York City's tax system. Based on his review of the history of tax policy changes over the past four decades, Parrott concluded: "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 permits that, and there are already some instances where such authority is delegated to the City, as with the authorization provided to the City to impose a sales tax on a broader range of services than the State or other local governments."

The Fiscal Policy Institute (www.fiscalpolicy.org) is an independent, nonpartisan, nonprofit research and education organization committed to improving public policies and private practices to better the economic and social conditions of all New Yorkers.

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