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Testimony of
Ron Deutsch, Executive Director
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Before the

Senate Finance and Assembly Ways and Means Committees

Joint Public Hearing on
Taxes

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Thank you for inviting me to testify today on the tax proposals in the FY 2017 Executive Budget and Financial Plan. My name is Ron Deutsch and I am the Executive Director of the Fiscal Policy Institute.

Income inequality has increased in New York during the recovery with income for the 1 percent growing faster than the average income for everyone else. New York's combined state and local tax structure is regressive and several rounds of substantial multi-year tax cuts in the past three years have done nothing, on net, to make the tax structure less unfair. When the current "millionaires' tax" expires at the end of 2017, it should be permanently replaced with the 1% Plan for New York Tax Fairness that will add four new, high-end tax brackets and continue the middle class tax cuts the governor initiated in 2012.

Since 2013, wage growth has started to pick up in New York after languishing in the early recovery years. Still, the average incomes of the richest 1 percent have grown four times as fast as the average incomes of the remaining 99 percent from 2009 through 2014. Adjusted for inflation, the incomes of the top 1 percent rose by 26 percent, while the average incomes of 99 percent increased by only six percent.[1]

People in the bottom of the income distribution are struggling. Incomes for most low-income New York households have fallen since the Great Recession began. As one gauge of New York's challenge, according to a Brookings Institution analysis of the largest cities in the United States, inflation-adjusted 20th percentile household income—i.e., incomes for households earning more than only 20 percent of all other households—fell between 2007 and 2014 by four percent in

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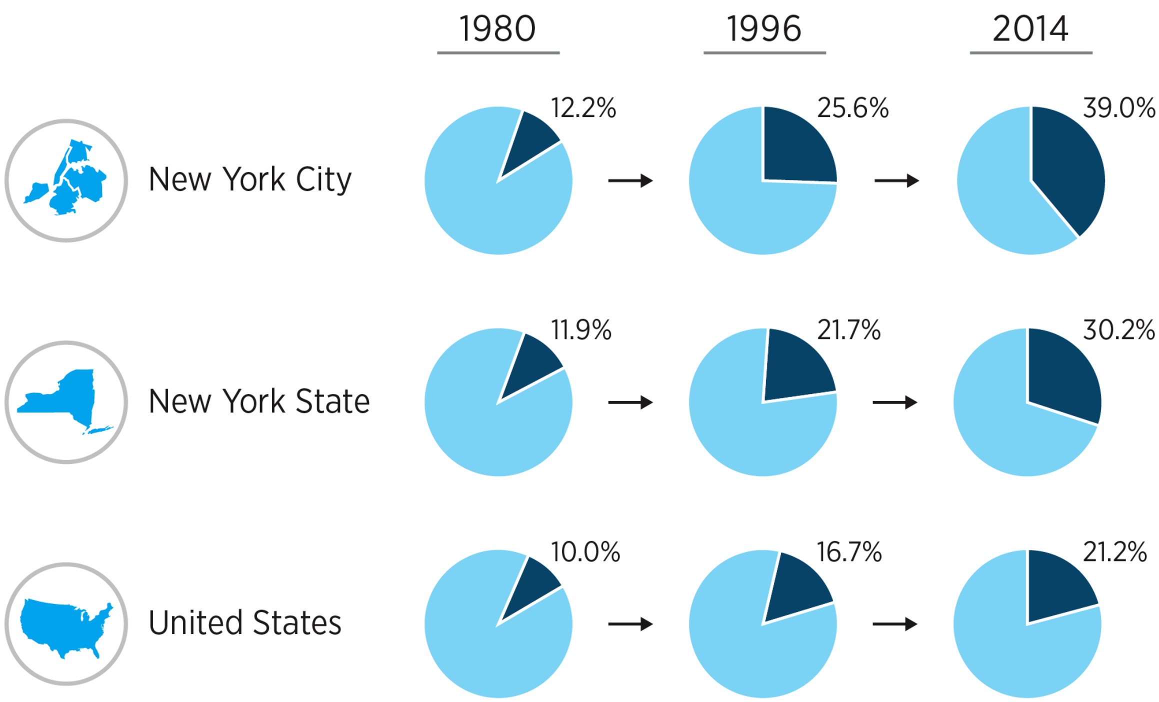
[1] Estette Sommeiller and Mark Price, The Increasingly Unequal States of America, Income Inequality by State, 1917 to 2012, Economic Policy Institute EARN Report, January 2015; 2013-14 estimates by the Fiscal Policy Institute based on 2013 IRS data and NYS Division of the Budget projections for 2014 income growth, January 2016.

Albany, six percent in Buffalo, nine percent in Rochester and New York City, and 15 percent in Syracuse.[2]

At the same time, those at the top are seeing extraordinary gains. In the United States overall, the richest 1 percent claimed 21 percent of all income in 2014. In New York State, with its concentration of both high- and low-income households, the top 1 percent received 30 percent of all income. And, in New York City, the top share was a staggering 39 percent in 2014. (That share was not quite as high as it was at the peak of the mid-2000s financial bubble, or as high as the year before the 2013 tax increases when the rich accelerated the receipt of capital gains and other income before federal top income tax rates rose in 2013. Still, the 1 percent's share has generally been rising for more than three decades.)[3]

Fig 1. A Bigger Slice of the Pie
The Growing Share of All Income Going to the Top 1 Percent



Source: Sommeiller and Price, Emmanuel Saez, and FPI estimates.

New York Incomes—Unequal by Class and by Race

- The average income of New York's richest 1 percent of tax filers was $2 million in 2014, compared to $47,300 for the remaining 99 percent.

[2] Alan Berube and Natalie Holmes, *City and metropolitan inequality on the rise, driven by declining incomes*, Brookings Institution, January 14, 2016.
[3] Sommeiller and Price, and FPI estimates. In New York State, the 1 percent share in 2007 was almost 33 percent, and in 2012 almost 32 percent.

- The average 1-percent income was nearly 43 times the average income of the 99 percent in 2014, up from 40 times the year before, and considerably greater than in 1979 when top incomes were about 13 times greater than the average incomes of everyone else.

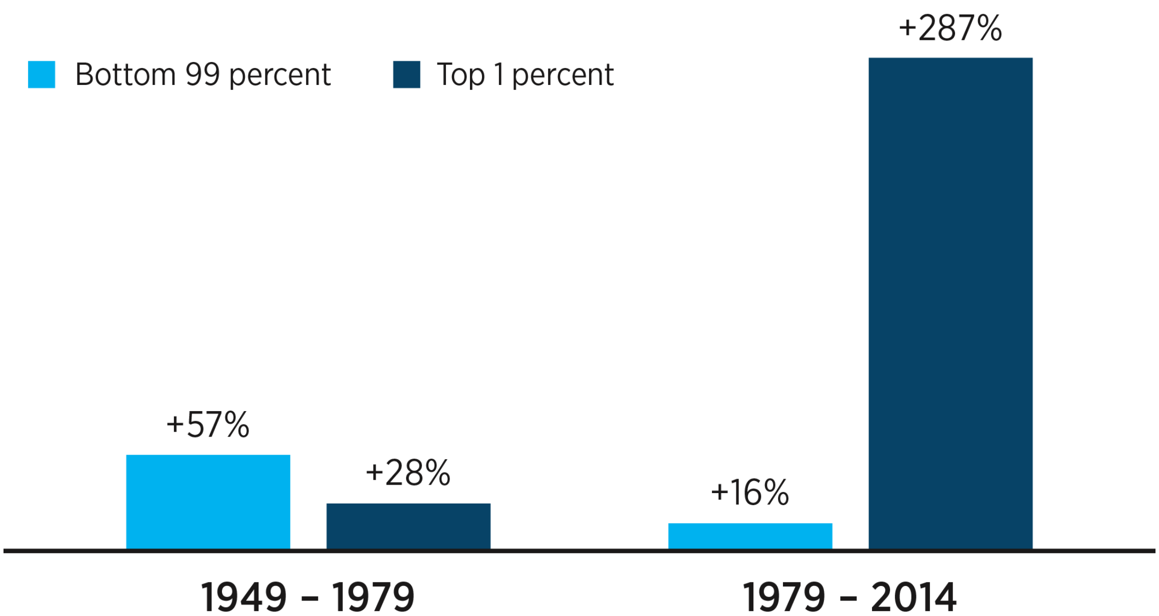
- New York families headed by a person of color were one-and-a-half times more likely than families headed by a white person to have very low incomes, according to data from the American Community Survey 2013 3-year data. (Very low income here refers to those in the bottom 20 percent of all families, or earning less than $29,200).

- Roughly two-thirds of black and Latino families were in the bottom half of the income distribution (64 percent of black families and 71 percent of Latino families).

- White families were four times more likely to be among the richest 10 percent of New York's families as black and Latino families.

As with all states, New York's income inequality has been on the rise since 1979, a sharp reversal of the patterns of income growth that prevailed for more than three decades following World War II. From 1949 to 1979, incomes rose across the board, with the middle class expanding dramatically in number and experiencing fairly steady income gains. For the past 35 years, most income gains have flowed to the very top.

Fig 2. A Sharp Reversal: Shared Prosperity vs Income Polarization in New York State



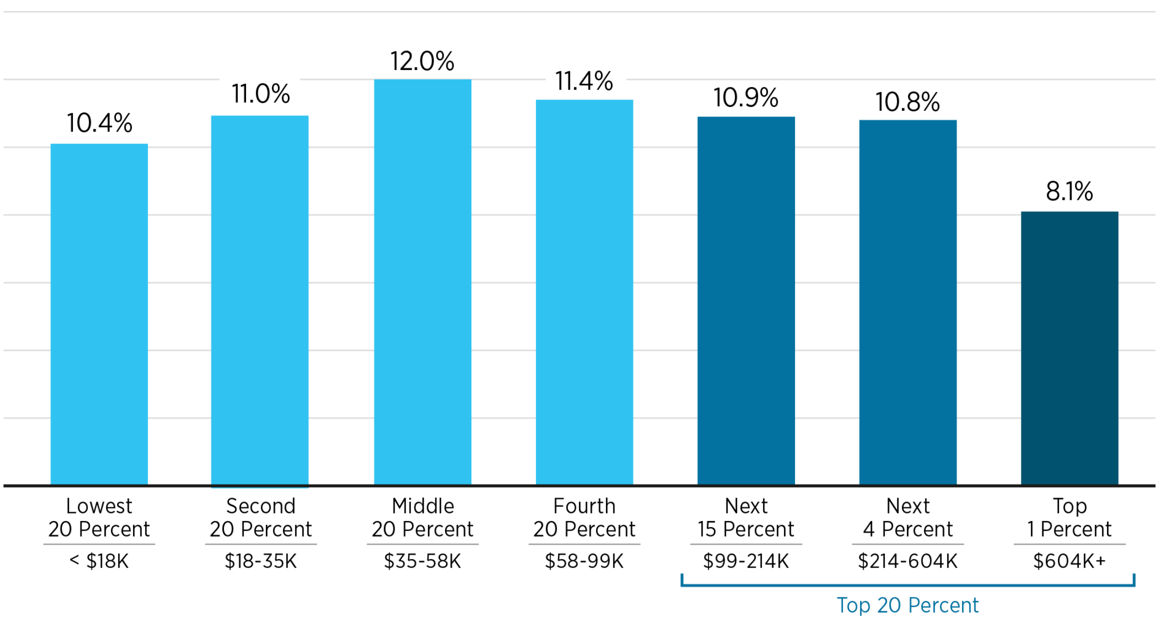
Source: Sommeiller and Price, Emmanuel Saez, and FPI estimates.

New York's Tax Structure Further Benefits the Wealthy

Those in the wealthiest 1 percent are taking home the lion's share of income gains, yet they nevertheless pay a smaller share of their income in combined state and local taxes than lower and middle-income families. New York households with incomes under $100,000 pay higher effective state and local tax rates (ranging from 10.4 percent to 12 percent) than the richest 1 percent of households (who pay 8.1 percent).

One reason the cumulative impact of state and local taxes is regressive is that most low- and middle-income New York families pay a greater percentage of their income in sales and property taxes than they do in income taxes. New York State income tax is mildly progressive, but not progressive enough to offset the effects of highly regressive sales and local property taxes.

Fig 3. New York State's Regressive State and Local Tax System
Percent of state and local tax burden by income group



Note: Shares of family income for non-elderly taxpayers.
Source: Institute on Taxation and Economic Policy, January 2015.

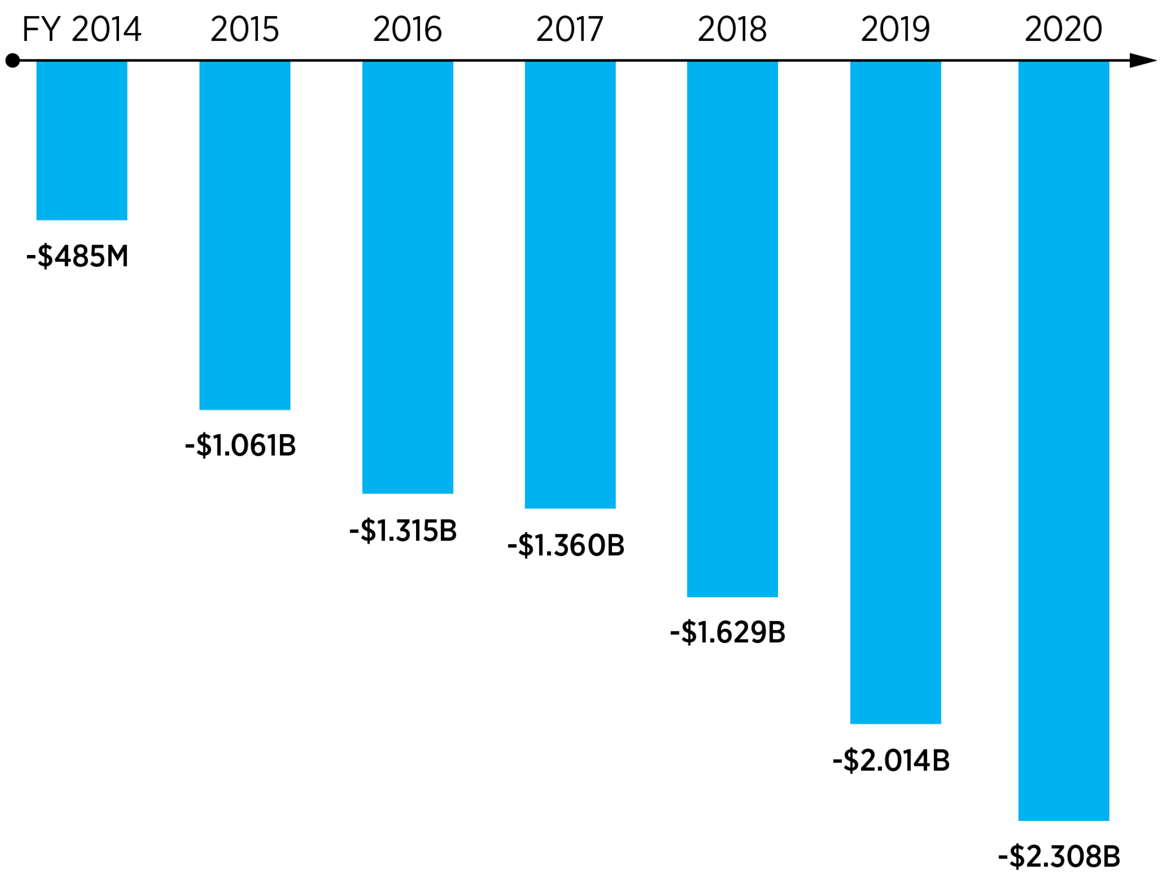
Recently Enacted Tax Cuts

Governor Cuomo has made a point of cutting taxes rather than maintaining services when revenues exceed his self-imposed two percent spending cap. This essentially means that budget cuts each year are used to pay for tax cuts. Tax cuts enacted in the last three years are reducing tax collections in the current 2016 fiscal year by an estimated $1.3 billion. Because some of these tax cuts are designed to increase each year, like the property tax relief credits adopted last June or the estate tax cut phased in beginning in 2014, the total amount of the already-enacted tax cuts will rise to $2.0 billion in FY 2019 and $2.3 billion in FY 2020.

Sometimes the governor has included tax policy measures in a budget package that result in a net gain in tax collections. For example: moves to limit the deductibility of charitable contributions by high-income taxpayers, or to close the resident trust loophole that was enacted in March 2014. However, in recent years revenue-raising measures have been far eclipsed by tax cuts.

Tax cuts in the past few years have mainly been either some form of business tax reduction or property tax relief. Two years ago, business tax cuts predominated, with the net 2020 value of that package amounting to nearly $700 million. That package included the elimination of the separate bank tax and a "corporate tax reform" that included a reduction in the corporate tax rate, the elimination of the capital base alternative tax, along with eliminating the tax on manufacturers and providing property tax relief to manufacturers.

Fig 4. Accumulating Tax Cuts Are Starving Revenues for Services New York Needs
Cost of tax cuts enacted in 2013, 2014, and 2015



Source: FPI analysis of NYS Division of Budget and Office of the State Comptroller enacted budget reports.

Last year, property tax relief took center stage. The legislature pushed for a different form of property tax relief than the governor proposed. The governor had advanced a "circuit breaker" approach that would have provided a credit against personal income tax liability based on the amount of property taxes paid in relation to income (an approach that FPI has long promoted on tax fairness grounds). The legislature instead opted for providing a flat amount in the first year (higher upstate than in the downstate region) and, in the second through fourth years, property tax rebates scaled so that the benefit declines as income rises, regardless of one's property tax bill. Recipients must be STAR eligible with incomes less than $275,000, and reside in a school district that did not vote to exceed the prior year's property tax cap. The price tag for the enacted package will rise from $400 million in FY 2017 to $1.3 billion in FY 2020, and total a substantial $3.1 billion over four years.

The property tax relief enacted last year will take the form of an annual property tax rebate check, with the first to be delivered in October 2016, on the eve of the November state legislative elections. The rebate checks sent on election eve this year will also include the final year's installment of the property tax freeze credit passed in 2014.

Key Tax Reduction Proposals in the Governor's FY 2017 Executive Budget

The governor has again advanced a deeply problematic Education Tax Credit, a proposal that was hotly debated but not enacted in the last legislative session. The core component of this year's proposal is a 75 percent personal or corporate income tax credit for donations made to a private or public school, excluding charter schools. As in previous years, the proposal has the extraordinary feature of a credit of up to $1 million, meaning that it is clearly geared to the very rich. The governor would allow $20 million in credits for public schools and $50 million in credits for private schools. Taxpayers must file applications to receive the credits, which effectively means they are allocated on a first come-first served basis.

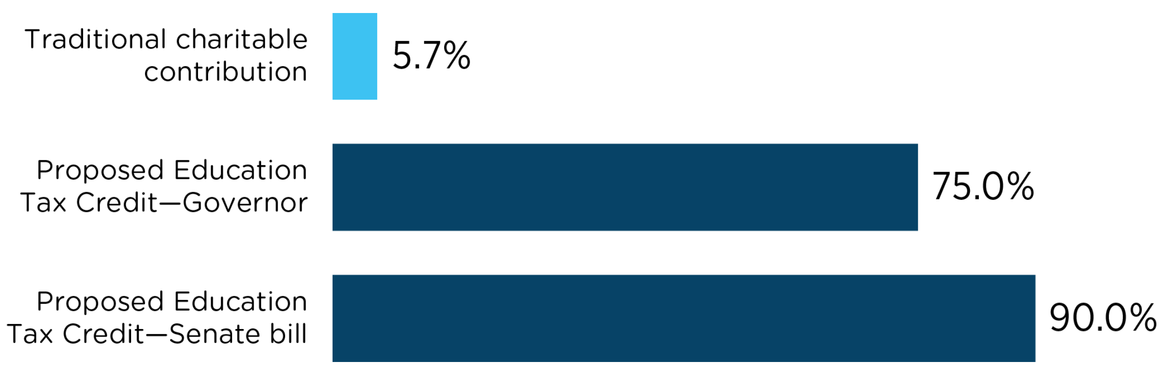
The governor's proposal adds two new features this year: a $200 refundable tax credit for teachers making out-of-pocket purchases of classroom supplies, and a refundable $500 credit per dependent for qualified private elementary or secondary school tuition geared to households with adjusted gross income of $60,000 or less. The governor's Education Tax Credit proposal would reduce taxes by $150 million annually, beginning in FY 2019.

Eager senate supporters of a far more generous education tax credit proposal approved that legislation on January 11, 2016. The senate measure provides a 90 percent tax credit with a $1 million individual limit, and includes charter schools as eligible donation recipients. The senate bill also has a much higher household income limit of $500,000 (the governor's proposal had a $250,000 income limit) for students who receive tuition grants funded with tax credit-eligible donations. The senate bill would reduce taxes by an annual average of $225 million over the next three years.

The **Education Tax Credit** proposal amounts to public funding of private schools, and a means for private donors to steer public dollars to the public schools of their choice. Public schools certainly need additional funding and that should be done through a direct increase in school aid, allocated through the state's foundation aid formula.

On more narrow tax policy grounds, the proposal flies in the face of sound, long-standing New York personal income tax policies. Most existing personal income tax credits in New York available to households are geared to lower–income households, or have fairly low maximum credit amounts or income eligibility limits. For example, expenses for mortgage interest payments or charitable contributions made by households are eligible for a deduction on state personal income tax returns. The effective value of the tax benefit for such deductions is a taxpayer's tax rate times the amount of the expense or contribution. Thus, at most, the effective "tax credit rate" for deductions is 8.82 percent, the state's top income tax rate. The state average effective income tax rate in 2011 was 5.7 percent—that is the benefit New Yorkers get on average for a charitable contribution. Last year the state extended a limit on deductions for charitable contributions by high-income taxpayers.

Fig 5. The Benefit of the Proposed Education Tax Credit is Extremely Large Compared to the Average Tax Credit on Charitable Deductions.
Tax Benefit as a Share of Contribution



In the FY 2017 Executive Budget the governor revives last year's proposed reduction in the corporate income tax rate from 6.5 percent to four percent for small businesses with income below $290,000, and adds a very costly tax reduction for small business owners paying business income taxes on their personal income tax returns (referred to as pass-through business entities.) The latter proposal would triple the existing small business/farm exemption from five percent to 15 percent and expand it to include non-farm limited liability corporations (LLCs), partnerships, and S-Corporation shareholders. Eligibility for the 15 percent exemption would be limited to taxpayers with net business income of less than $250,000. Still, many LLCs are not really small businesses in the commonly understood sense of a neighbor operating a local store or service, but are rather vehicles for financial or real estate investment partnerships. There is no reason to provide such entities a tax exemption on up to $25,000 of business income. These two small-business tax reductions would reduce revenues by $276 million annually beginning in FY 2018. Most of the savings would be realized by small businesses organized as LLCs or S-Corps.

Last year when the governor proposed the corporate tax rate reduction for small businesses, he also proposed a package of tax enforcement and compliance measures that would generate offsetting revenues. In response to continued growth in online sales through marketplace providers like Amazon and eBay, the governor proposed that such providers be required to collect New York sales tax when they facilitate a sale between an out-of-state seller and a New York consumer. This measure would have helped level the playing field for New York's brick-and-mortar retailers. It would have generated nearly $60 million a year, but was not enacted last year and unfortunately, has not been proposed so far this year. Other enforcement measures proposed last year would have generated $30 million when fully implemented.

A more effective way to provide tax relief to small businesses would be to provide property tax relief through the personal income tax based on a circuit breaker approach. This would gear relief in response to property tax payments that were truly burdensome in relation to business income, and would respond to the concern that property taxes are a fixed cost for businesses and not a function of profitability. Two years ago, the state enacted a 20 percent property tax credit for manufacturers. A circuit breaker approach would allow for relief to be targeted to businesses with higher relative property tax burdens. Offsetting revenue-raising enforcement and compliance measures, such as requiring marketplace providers to collect the sales tax, would have the added benefit of leveling the playing field for New York's small businesses.

The Executive Budget includes a proposal to convert the STAR benefit from a local property tax exemption to a refundable state personal income tax credit for new homeowners and homeowners who move. The budget proposal also freezes the exemption benefit for all homeowners in place of the current two percent cap on the year-to-year increase in the exemption. The conversion will affect the financial plan by reducing spending and increasing state tax expenditures, and by a timing difference, with the cost of the income tax exemption for a given year being booked in the following fiscal year. The taxpayer benefit will remain the same. The conversion also changes the New York City personal income tax STAR credit into a state personal income tax credit.

In the senate majority's analysis of the Executive Budget, it is suggested that New York City's real property taxes should be subject to the two percent cap that applies to localities outside of New York City. The report notes the recently announced 10-plus percent growth in the estimated market value of all real property in the city and the projected six percent growth in property tax revenue over the next four years. The senate majority report also suggests that serious consideration should be given to phasing out the city's commercial rent tax.

But, the senate analysis fails to recognize that the city's overall local tax structure for households is regressive. The most compelling need is to make residential property taxes less regressive. Analysts across the policy spectrum agree that provisions of the state's real property tax law have created a complicated series of inequities both within and between the 1-, 2-, and 3-family home Class I and the rental, coop and condo residential units in the city's property tax Class II. In particular, since it is widely understood that much of the property tax for rental units is passed on to tenants, tenants bear the highest effective property taxes among residential properties.

To phase in a more equitable system of effective property tax rates, the problems with the state property tax law should be fixed and a robust circuit breaker tied to the city's personal income tax will be needed to ensure that property tax burdens relative to household income are kept manageable. On the commercial side, the city should act to end the very costly and unneeded Hudson Yards property tax breaks, and the city and the state should revamp other commercial property tax breaks that now disproportionately benefit real estate developers at the expense of small commercial property owners. Regarding the commercial rent tax, it should be kept in mind that it only applies to the densest parts of Manhattan, that most of the rent tax is paid by well-heeled financial and professional services tenants, and that reducing it is unlikely to lead to lower net tenant payments for the combination of rent and rent tax since landlords likely will raise rents in response to a reduction in the rent tax.

1% Plan for New York Tax Fairness—Permanently Extending the "Millionaires' Tax"

The best response to the regressivity of New York's overall state and local tax system is to make the personal income tax more progressive. To do that, New York should build on the current tax structure originally proposed by Governor Cuomo in December 2011, and that is set to expire at the end of 2017. The state should increase the number of brackets from eight to 12 and make the new structure permanent. This proposal, outlined in this chart, would retain the slight middle-class tax breaks the governor introduced then, and increase tax rates slightly for the richest 1% of New York's taxpayers, i.e., those with incomes over $665,000. The Fiscal Policy Institute labels this the "1% Plan for New York Tax Fairness."

The Fiscal Policy Institute estimates that the 1% plan would raise income tax revenues by $2.2 billion, with 17 percent of that amount paid by out-of-state residents. If the "millionaires' tax" is not extended, New York State would suffer a net $2.7 billion revenue drop that would entail a $1 billion tax increase for moderate- and middle-income families with incomes from roughly $40,000 to $300,000, while the richest 1% would get a $3.7 billion windfall.

Fig 6. 1% Plan: Increase Personal Income Tax Rates Incrementally for Top 1%

TAXABLE INCOME RANGE	PERMANENT LAW	CURRENT RATES THROUGH 2017	PROPOSED 1% PLAN	1% PLAN COMPARED TO CURRENT RATES
Up to $16,000	4.00%	4.00%	4.00%	
$16,000 - $22,000	4.50%	4.50%	4.50%	
$22,000 - $26,000	5.25%	5.25%	5.25%	
$26,000 - $40,000	5.90%	5.90%	5.90%	NO CHANGE
$40,000 - $150,000	6.85%	**6.45%**	6.45%	
$150,000 - $300,000	6.85%	**6.65%**	6.65%	
$300,000 - $665,000	6.85%	6.85%	6.85%	
$665,000 - $1,000,000	6.85%	6.85%	7.65%	+0.80%
$1,000,000 to $2,000,000	6.85%	6.85%	8.82%	+1.97%
$2,000,000 - $10,000,000	6.85%	**8.82%**	9.35%	+0.53%
$10,000,000 - $100,000,000	6.85%	**8.82%**	9.85%	+1.03%
Above $100,000,000	6.85%	**8.82%**	9.99%	+1.17%

Note: Beginning in tax year 2013, tax brackets have been indexed each year for the change in the consumer price index. Also, the $2 million threshold for the current top tax bracket applies to the married, filing jointly tax filer status. The top bracket threshold for single and head of household filers is $1 million. For simplicity, the above chart does not reflect these changes.

Other actions that would lessen the overall regressivity of New York's taxes include an enhancement to the state's Earned Income Tax Credit (currently set at 30 percent of the federal EITC), and enhancements to the Child and Dependent Care Tax Credit to increase benefits for households with incomes up to $80,000. Child care credit increases will be particularly needed as the minimum wage rises to $15 an hour since over 90 percent of child care workers are currently paid less than that amount.

Tax Policy/Revenue Recommendations

- **Adopt the 1% Plan for New York Tax Fairness**

  New York's overall state and local tax system is regressive. The state personal income tax should be made more progressive to offset regressive property tax, sales tax, and other taxes that result in an overall regressive state tax system. New York should build on the current tax structure originally proposed by Governor Cuomo in December 2011, which is set to expire at the end of 2017, by increasing the number of brackets from eight to 12, and making the new structure permanent. The 1% plan retains the middle-class tax reductions introduced in 2011, and generally increases tax rates slightly for the richest 1 percent of New York's taxpayers (those with incomes over $665,000). This would raise income taxes for the top 1% by $2.2 billion, with 17 percent of that paid by out-of-state residents. If the "millionaires' tax" is not extended, New York would suffer a net $2.7 billion revenue drop that would entail a $1 billion tax increase for moderate and middle income families while the richest 1% would get a $3.7 billion windfall.

- **Do Not Pass the Misguided Education Tax Credit**

  This proposal is nothing more than a $150 million diversion of taxpayer resources to privately determined educational uses. It would provide an unprecedented 75 percent tax reduction relative to a contribution and has the potential to lessen charitable contributions for a range of worthy causes. There is no provision to avert a situation where wealthy donors, corporations, and financial partnerships would claim all or a lion's share of the credits. These funds would be better invested in expanding the governor's positive proposal to expand the number of community schools, a proven way to give real opportunities to students in struggling schools.

- **Fix "Corporate Tax Reform"**

  Changes should be made to improve the corporate tax reform that was enacted in 2014. The changes were meant to be revenue neutral, but in fact will end up costing well over $500 million annually. To make up for this lost revenue, the state should make permanent the 0.15 percent capital base alternative tax rate and raise the cap to $10 million, and should enact the investment tax credit reforms Governor Cuomo proposed in 2014.

- **Reform and Curtail Business Tax Credit Programs**

  Reduce the amount of money ill-used in the name of economic development and redirect it to bolster economic growth. Tax credits have tripled to $1.8 billion in the past decade, yet they have a negligible impact on job creation. The governor's own tax commission recommended curtailing the scattershot use of tax credits. These funds can be better used as investments in smart economic development.

- **Amend the Property Tax Cap**

  The property tax cap is the wrong solution to the state/local tax problem, and it should be eliminated. Short of being eliminated, there are modifications that would at least minimize its damage to schools and local governments. The cap should be amended to allow for a simple majority override rather than requiring a 60 percent supermajority. The cap should also have exclusions for local expenditures for emergencies, capital improvements, infrastructure, and enrollment.

- **Fairly Tax Carried Interest**

  Authorize New York City to tax carried interest on the same footing as that of thousands of smaller businesses, and modify the state nonresident personal income tax to include New York income received from investment management services that is not now taxed.

- **Scrap the State Spending Cap**

  Eliminate the governor's self-imposed two percent cap on state spending. State tax revenues, total wages, and personal income are projected to grow by four to five percent annually over the next four years. There is no reason to hold annual spending growth below two percent if it means that we are under-investing in education and poverty reduction. This unforced austerity has already caused the state to underinvest in several critical areas, and the continuation of the cap guarantees further harmful cuts to local governments, education and human service programs.

- **Move Toward Having the State Carry a Fair Share of Joint State/Local Costs**

  Restore the state's role as a reliable partner to local governments. Rather than assisting local governments, the state has put them in a position where they first had to choose between raising taxes and cutting local services, and more recently have had only the option to cut services and the false promise of huge savings through consolidation and other efficiencies.

- **Increase the State Earned Income Tax Credit**

  The state EITC is currently set at 30 percent of the federal EITC; increasing it to 40 percent would help lift many hard-working families out of poverty. State EITC benefits should also be expanded to aid childless workers ages 20-24 and those 65-66, and to increase amounts for childless couples. Adopt the executive proposal to make permanent the Earned Income Tax Credit provisions that apply to non-custodial parents.

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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.