

Short Term Tax Relief and  
Long Term Tax Reform:  
An Omnibus Bill Approach



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The administration of the property tax can be improved. And such improvements should be made. But even if the assessment process were perfect, and all properties were assessed at exactly their true market value, criticisms of the property tax's "fairness" would still remain.

The attention that is currently being given to property tax issues in New York State is in large part the result of the efforts of organizations and individuals who, for a variety of reasons, have argued for years that the property tax should be replaced completely; or that it should be replaced as the basis for school funding; or that New York State should substantially reduce its reliance on the property tax for economic policy reasons or for tax fairness reasons. While differing in their emphasis and advocacy style, all of these people and organizations shared an interest in a classic type of "tax reform." Whether consciously or unconsciously or subconsciously they were all saying in one way or another that, as far as they were concerned, the property tax is not sufficiently related to various homeowners' relative "ability to pay."

Despite the "tax reform" roots of the current property tax debate, tax reform options are receiving virtually no attention as elected officials, the media, advocates and the general public consider a variety of approaches to tax relief.

This is not really surprising, given the fact that between 30 and 40 percent of homeowners in the state have property tax bills that represent unacceptably large percentages of their income. But it is disappointing to many of us who want to make the New York's overall tax system more equitable by reducing the state's reliance on local property and sales taxes and increasing its reliance on taxes based on ability to pay, primarily the individual and corporate income taxes. Thus, our interest is in legislation that combines meaningful property tax relief in the short run with a long run plan for reforming the state-local tax system. In addition to providing for the assumption by the state, over a reasonable period of time, of a targeted \$10 billion in local government responsibilities, the long run plan for reforming the state-local tax system should also provide for the creation of a tax reform study commission, with members to be appointed by the Governor and all four parties in the Legislature, and the establishment of a statutory requirement for both a periodic study of the incidence of the overall state-local tax system and analyses of the distributional impact of proposed tax legislation.<sup>1</sup>

### **Property tax relief: An immediate need**

During the last two years, local real property tax reform groups have been successful in making the wonky idea of a middle class circuit breaker a front burner issue in New York State government and politics. Large portions of the public understand what a circuit breaker is, and there is broad public support for the idea of a middle class circuit breaker as a way to deal with situations in which homeowners are significantly overburdened by

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<sup>1</sup> Three states—Maine, Minnesota, and Texas—have enacted laws of this type. These three states and two others (Colorado and Oregon) have completed periodic studies of the incidence (i.e., the distributional impact) of their tax systems.

their property taxes. But a dilemma regarding the funding of such a circuit breaker may end up stopping its enactment for the time being.

The main circuit breaker bill pending in the Legislature, referred to as the Galef/Little bill after its main sponsors, would create a relatively generous middle class circuit breaker. It endeavors to limit the cost of this property tax relief by establishing a 5-year residency requirement (which reduces the estimated annual cost of the proposal from about \$2.5 billion to about \$1.65 billion) and by excluding renters from participation (which eliminates an estimated \$1.3 billion in costs). It then proposes to cover the \$1.65 billion cost of the circuit breaker by eliminating the STAR rebate check program, which was established in 2006 and substantially restructured in 2007. This switch or swap would eliminate a program that provides relatively small checks to all homeowners and establish a circuit breaker credit that will provide significant relief to those homeowners who are truly overburdened by their property taxes. While most of us in this room would probably support this swap, there is opposition in some important quarters in the legislature to the idea of taking this benefit away from many homeowners. Some legislators would be willing to cover the cost of the circuit breaker by a high-end income tax increase, but this alternative may also fail to attract the level of support necessary for enactment.

While there are some changes that we would like to see in the substance of the circuit breaker proposal, and while the state's current budget outlook creates a large number of competing demands for the revenue that could be produced by a high end income tax increase, the enactment during the upcoming special session of the legislature of a significant middle class circuit breaker financed in either of those two ways, would be an extremely important and significant victory for hard pressed homeowners. If a middle class circuit breaker is not enacted in the upcoming session because of concerns with the two possible funding mechanisms now being discussed, consideration should be given to the possibility of phasing in this relief mechanism through one or more of the following or similar means:

- Increasing the income limit in several annual or biennial steps rather than beginning with the \$250,000 income limit included in the current legislation
- Decreasing the percent of income threshold in several annual or biennial steps (i.e., starting at eight or nine percent of income and then reducing that percent to the six, seven and eight percent limits contained in the current legislation)
- Establishing a maximum credit amount and then increasing that maximum amount in several annual or biennial steps.

In terms of the substantive recommendations, two seem relatively easy to resolve (either positively or negatively) while two others will take time and/or money:

- (1) Given a particularly compelling issue of the times, household income for purposes of the circuit breaker should not include, for some reasonable number of years, disability compensation received by veterans on account of an injury or illness incurred or aggravated during military service in the post-9/11 wars in Afghanistan and Iraq

- (2) The criteria for determining a homeowner's eligibility for circuit breaker relief and for determining the amount of such relief should not vary with the homeowner's place of residence;
- (3) The tax reform study commission should use the results of the first study of the incidence of New York's state-local tax system to review the distributional impact of the items of income included in the definition of household income for purposes of the circuit breaker and make recommendations to the governor and the legislature for any changes in this definition that the commission deems appropriate;
- (4) The middle class circuit breaker should include renters particularly if it is to be funded by an increase in the income tax or in some other tax of general applicability.

### **Tax reform: A continuing priority**

The core idea of the tax reform part of the omnibus bill will be to increase the progressivity of the state income tax and to use the revenues produced for a reduction in local property taxes by shifting additional costs from the local to the state levels.

In thinking about ways of substantially reducing the reliance on the property tax, two approaches provide useful starting points. First, Assemblyman Kevin Cahill and Senator Kenneth LaValle have introduced similar bills that would have the state government assume all of the costs of what those bills refer to as a "basic quality education," with the details to be fleshed out by the Commissioner of Education under guidelines to be established by the state legislature. These two bills each provide (different) mechanisms for funding, at local option, of educational services above the basic quality education level. Second, the state Senate has, on several occasions, passed versions of legislation (referred to as NY-STOP or Stop Taxing Our Property) that provides for the state government to take over responsibility for funding the portions of school budgets (for purposes other than debt service) that are currently funded by property taxes on owner-occupied primary residences.

The foundation formula reform plan that was enacted into law in 2007 represents an important breakthrough in the way that the state government shares in the costs of a sound basic education. By establishing a method for calculating, for each school district in the state, a foundation funding level (i.e., a funding level akin to that referred to as a basic quality education in the Cahill and LaValle bills), this 2007 law provides a basis for estimating the cost of these bills. The foundation funding formula established in 2007 also provides a basis for making sure that the approach embodied in the Senate's STOP bills would, if enacted, treat all school districts in the state on a fair and equitable basis. Since some school districts spend well above the foundation level in order to provide their students with a very high quality education, while others are still funding their schools at levels below the foundation level, taking over whatever school districts are currently spending would institutionalize those inequities while providing state aid to school districts on a very inconsistent basis.

The foundation funding level for the 2010-11 school year for all of New York State's school districts, under the foundation formula law as enacted in 2007 and as modified earlier this year, is an estimated \$36.1 billion. Based on the statutory formulas by which responsibility for funding this foundation amount is divided between the state and the local school districts, it is anticipated that in 2010-11 that the state will provide an estimated \$18.5 billion is foundation aid to those local districts. All of this assumes that the state government will honor the multi-year school funding commitments that it made in 2007 to settle the Campaign for Fiscal Equity, and we certainly hope that this turns out to be the case. But we must acknowledge that there is at least some uncertainty given Governor Paterson's economic and budget forecasts.

If the state were to assume responsibility for funding 100 percent of the foundation amount, as suggested by the Cahill and LaValle bills (and if such a commitment were fully phased-in in 2010-11, which it will not be), it would mean that the state would be responsible for an additional \$17.66 billion of local school costs. So rather than making this assumption, we suggest that once the initial 4-year phase-in of the new foundation formula is completed in 2010-11 and the State Education Commissioner has completed an updating of the basic "per pupil foundation amount" that the state government, in addition to paying its current share of the foundation amount, that the state also gradually increase its share of the foundation amount. We suggest that the omnibus bill include a commitment to accomplish \$6 billion of such shifting of responsibility from the local property tax base to the state tax base over the course of the decade beginning in 2011 and ending in 2020.

Earlier, we indicated that the omnibus bill should provide for the assumption by the state, over a reasonable period of time, of \$10 billion in local government responsibilities. So where is the other \$4 billion?

At its meetings and in its report, the Suozzi Commission has constantly repeated that school property taxes account for 62 percent of all local property taxes in New York State. This is true only if we count the STAR reimbursements provided to school districts as taxes paid by property owners. Statewide, if we treat STAR as what it is (i.e., state aid), we see that the school taxes that property owners pay makes up 56 percent of local property taxes statewide—but that figure varies tremendously. It's 37 percent in Allegheny County, 37 percent in Fulton, and 39 percent in Cortland and Cattaraugus counties, but it's 71 percent in Saratoga and Putnam counties. Why the bigger differences? Because some counties have much greater concentrations of needy individuals relative to their tax bases than do other more prosperous counties. And that ends up making the local share of costs such as Medicaid a much greater lien on some counties' tax bases than on others. Similarly, some counties have one or more older cities and/or villages with responsibilities for urban services.

One important lesson is that we should not make public policy based on averages. So, in addition to recommending that we shift \$6 billion of school costs from the local school property tax base to the state tax base, we suggest that we do something similar in regard to revenue sharing with the state's cities, towns and villages, and in regard to the division

of responsibility for the non-federal share of Medicaid costs.

For general-purpose local governments, cities, towns and villages, the primary pressure that the state has placed on local governments is a negative. It's because of not sticking to its revenue sharing commitment. The underlying law, which gets notwithstanding every year, is that the state is supposed to share 8 percent of revenue with local governments. In the 1980s, when Governor Carey was governor, we had our first freeze on revenue sharing in order to allow one of the state's earliest multi-year income tax cuts to be phased in as scheduled despite the recession that the nation was then experiencing. In the budget problems of the early 1990s, no major state program was cut more than revenue sharing—from over \$1 billion a year to less than \$500 million a year. My recommendation in this regard is that over the course of the 2011 to 2020 decade that the state phase in a \$3 billion increase in revenue sharing with its cities, towns and villages,

In regard to Medicaid, the state should honor its commitment to picking up increases in the local share in excess of 3 percent per year. But in addition to this, we recommend that the omnibus bill include language that will gradually increase the state share of Medicaid costs in a way that bases each county's share of Medicaid costs on objective measures of each county's relative "ability to pay" and, in the course of doing so, shifts an additional \$1 billion in costs from the local property tax base to the state tax base.

Between now and 2010, the state may very well need to enact a temporary income tax surcharge to get through the recession—similar to the temporary personal income tax increase that was enacted in 2003 for three years. If it does take such a step, it should continue that tax increase as a source of funding for the property tax reductions being recommended for implementation during the coming decade.

This approach is less costly than the Cahill and LaValle bills, but it is more balanced geographically. Putting all \$10 billion into taking over the full cost of the foundation formula would have a much greater impact on the overall property tax burden in more prosperous counties and less of an impact in less prosperous upstate counties. The omnibus bill will also establish a process by which the governor and the legislature are required to consider a much greater takeover of local costs as part of the annual revenue forecasting and budget making process.



*The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on tax, budget, and economic issues that affect the quality of life and the economic well being of New York State residents.*

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