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Testimony

of

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before the

Senate Standing Committee on Local Government

Assembly Standing Committee on Real Property Taxation

Public Hearing on Proposed Legislation Addressing Real Property Taxation Issues

June 2, 2008

The Middle Class STAR rebate program is better targeted than the original STAR program in that in takes income into consideration. But it is still not adequately targeted to be an effective and efficient property tax relief mechanism since it does not take the size of a homeowner's property tax bill into consideration and it is still based on county and school district average of important variables.

A circuit breaker like S.1053-a/A.1575-a would address both of these shortcomings. Among the main improvements that this bill needs is a broader definition of income - something like the definition of income in the state's current circuit breaker law. As currently written, the bill takes some types of income into consideration but not other types, despite the fact that all types of income are available to pay property taxes.

The Middle Class STAR rebates cost approximately $1.1 billion in the 2007-2008 state fiscal year. That figure, under current law, is estimated to grow to $1.23 billion in 2008-2009, $1.45 billion in 2009-2010 and $1.69 billion in 2010-2011. Using the microdata from the US Census Bureau's American Community Survey for 2006, we have estimated that S.1053-a/A.1575-a would cost approximately $1.64 billion per year if all eligible households applied for this credit. We estimate that the cost of this proposal would increase to about $2.5 billion if the bill's 5-year residency requirement were dropped. Such a change would also increase the number of households eligible for credits from about 940,000 to approximately 1.44 million, just about half the number of households that received rebate checks during 2007-2008.

One of the most striking things about these estimates is the magnitude of the credits for which some households would qualify. For example, the estimate of the maximum credit in the below $75,000 income range was an estimated $11,500. These numbers (and the differences between the mean and the median credits) indicate that many households have very large property tax bills relative to their incomes. The STAR exemptions and the Middle Class STAR rebate checks are providing aid to many households for whom property taxes are a very reasonable percentage of income, while the aid being provided is not sufficient to assist those who are truly overburdened by property taxes and who in the words of Governors Pataki and Spitzer are literally being forced out of their homes. The Middle Class STAR program is a step in the right direction by taking household incomes into consideration, but unless the size of households property tax bills are also taken into consideration, more aid will still go to households with reasonable property tax burdens relative to their income, and not enough aid will go to those who are truly overburdened.

In addition to the property tax relief that a circuit breaker credit can give to homeowners, it can also address the impact of property taxes on renters. New York State's current circuit breaker program, which applies only to very low income households (those with incomes below $18,000), allows tenants to count 25 percent of their rent as their "property tax equivalent" and then use the same formula to determine if they are eligible for a credit. S.1053-a/A.1575-a does not provide any coverage for renters but it could be built upon to do so in future years. While the percent of rent that is counted as a tenant's "property tax equivalent" should probably decline as income increases (particularly in the income ranges covered by S.1053-a/A.1575-a, it does not seem defensible to exclude renters entirely. In the short run, however, S.1053-a/A.1575-a is clearly an improvement over the Middle Class STAR rebate program, which also excludes renters.

The definition of income in S.1053-a/A.1575-a is the same as the definition of income that was used for the Middle Class STAR rebates. That definition of income is not actually in the law establishing the Middle Class STAR rebates. Rather, it is incorporated into the Middle Class STAR rebates program by reference to the provision of law that established the definition of income for the enhanced exemption for property owned by senior citizens under the original STAR program. As far as we have been able to determine, the definition of income for the enhanced exemption for property owned by senior citizens under the original STAR program was written the way it was to be consistent with the way the local option senior citizens exemption was being administered.

Based on a 1984 opinion of the SBEA Counsel, the SBEA was having IRA distributions subtracted from income in calculating income eligibility for that program. As I understand it, that 1984 Opinion (Volume 8, Opinion 22) reached that conclusion as an extension of having first concluded that contributions to IRAs had to be added to back to income in the year in which those contributions were made; and that it would be wrong to include IRA distributions in calculating a person's Section 467 eligibility if, in earlier years, that person had to add his or her IRA contributions to his or her income in determining his or her Section 467 eligibility.

This "double taxation" analogy, which motivated the 1984 opinion about the local option senior citizen exemption, is not applicable to the enhanced exemption for property owned by senior citizens under the original STAR program or to the Middle Class STAR program since in neither of those programs are taxpayers required to add back the amount of their IRA contributions to their income in years in which they make such contributions.

I think it would be a mistake to carry this unequal treatment of equals over to a new Middle Class Circuit Breaker just because it exists, by historical error, in the Middle Class STAR rebate program and in the enhanced STAR exemption for senior citizens. In addition, standardizing the definitions of income used in the various property tax relief programs would be a worthwhile (and maybe more difficult) effort.

Attachment A

http://www.orps.state.ny.us/legal/opinions/v8/22.htm

Volume 8: Opinions of Counsel SBEA No. 22

Aged exemption (income requirement) (retirement benefits-IRA's)—RPTL, §467; 26 U.S. Code §408:

For the purposes of determining whether an applicant for the aged exemption satisfies the local income requirement, contributions to an individual retirement account (IRA) are not deductible; earnings on IRA's should be considered as income; and distributions from IRA's should not be treated as income.

We have been asked whether a 69 year old applicant for the aged exemption must include the undistributed earnings from his Individual Retirement Account (IRA) in computing his income for purposes of the exemption. According to the applicant's bank statement, he received no distributions from his IRA in 1982 but did earn $4,958.55 in that account.

Among the requirements of section 467 is that the income of owner(s) of the property (including an owner's spouse's income where the spouse is not an owner) may not exceed the income ceiling established by the municipal corporation in which exemption is sought. Income is defined to include "social security and retirement benefits, interest, dividends, total gain from the sale exchange of a capital asset in the same income tax year, net rental income, salary or earnings, and net income from self-employment, but shall not include a return of capital, gifts, or inheritances."

Section 408(a) of Title 26 of the United States Code defines an "individual retirement account" as "a trust created or organized the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets … [various enumerated] requirements." Under the terms of an IRA, in general:

1. An individual may set aside and deduct up to $2,000 annually from his gross income for income tax purposes (26 USC §219(b)).
2. No deduction is allowed for contributions made in the year the individual attains the age of 70½ or in any later year (26 USC §219(d)(l)).
3. The income earned by an IRA is tax exempt until it is distributed (26 USC §408(e)).
4. The distributions from an IRA (*i.e.*, combined principal and interest) are fully taxable as ordinary income when paid out (26 USC §219(d)(l)).
5. Distributions made before the year in which the payee attains the age of 59 1/2 are subject to penalty, but distributions must be made or at least begin in the year in which the participant attains the age of 70½ (26 USC §408(f)(a)); *see also*, 33 Am.Jur.2d, Federal Taxation (1984), 3900 *et seq*.).

Notwithstanding the Federal income tax treatment of IRA's for [purp]oses of determining eligibility for the aged exemption, in our opinion, contributions to such accounts are not deductible from income, and earnings on IRA's should be considered as income, but distributions from IRA's should not be treated as income.

Contributions to an IRA

To receive an aged exemption, property must be owned by all of whom are at least 65 years of age, except for property owned by a husband and wife, only one of whom need be 65, and except where property had been receiving an aged exemption based on an older spouse's age and such spouse dies leaving a surviving spouse who is at least 62 years old (RPTL, §467(1)). Thus, all applicants for the aged exemption are of an age to qualify to receive distributions from their IRA's without penalty, and those applicants for exemption who are less than 70½ years old may still be making contributions to an IRA.

In our opinion, voluntary contributions to any retirement plan cannot be excluded from the computation of income for purposes of section 467. The purpose of the aged exemption is "to help elderly persons *living on small fixed incomes* to remain in their homes despite increases in real property taxes …" (Governor's Approval Memorandum for L.1966, c.616; emphasis added). To allow persons to exclude contributions to voluntary retirement plans from their incomes and thereby qualify for exemption and shift the tax burden to others would be inconsistent with this stated intent.

In *Engle v. Talarico*, the Court of Appeals quoted the above-cited memorandum, and also stated:

> The Legislature expressed no intention of incorporating the Federal or State tax rules into the exemption statute. Absent direction to the contrary, the term "income," as used in the particular statute, must be judicially construed. That construction must be an accommodation between a common understanding of the term and the legislative purpose, however indefinitely projected by the statutory language (33 N.Y.2d 237, 240-41, 306 N.E.2d 796, 351 N.Y.S.2d 677, 679 (1973)).

In responding to inquiries regarding the income requirement of the statute, we have said that income includes unemployment insurance benefits (2 Op.Counsel SBEA No. 50), dependency and indemnity compensation (1 *id.* No. 109), and payments to a retired former employee from a non-contributory trust fund (5 *id.* No. 1). We have also concluded that personal medical expenses cannot be excluded from income (2 *id.* No. 65). Given the statutory purpose of section 467 and our prior opinions, we conclude that contributions to an IRA are not excludable from income for purposes of section 467.

Earnings on an IRA

We have stated that income for purposes of section 467 includes interest on U.S. Savings Bonds when the bonds are cashed (1 *id.* No. 98) and interest on U.S. Treasury Notes (6 *id.* No. 119). We have also stated, that "[i]nterest earned on a bank savings account …

affect[s] the annual cash inflow of the taxpayer in that he is free to withdraw the amount of interest annually, or at any time he chooses, leaving the principal intact on deposit" (1 *id.* No. 98). Since all applicants for the aged exemption are more than 59½ years of age, the proceeds (including the earnings) in an IRA are as readily available to them as is interest in a bank savings account. Based on this fact and our prior opinions, we conclude that the earnings of an IRA are income for purposes of section 467.

Distributions from an IRA

Since it is our opinion that contributions to an IRA are not excludable from the income calculation, and earnings on such accounts should be included in income, the distributions from an IRA (representing principal and earnings), although taxable for Federal income tax purposes, should not be considered as income for purposes of section 467. To do so would be to treat the same moneys as income both when they are paid into and out of the IRA.

This latter consideration lends further support for our conclusion. It is our understanding that distributions from an IRA are not designated as being principal or earnings. This is because the full amount of the distribution is taxable and the status of the proceeds is irrelevant for income tax purposes. Since it is clear that no deduction for contributions to an IRA should be allowable for purposes of section 467, and those contributions are indistinguishable from the earnings thereon when distributions are made, it would not be feasible for an assessor to identify and consider only the earnings portion of an IRA distribution as income. From an administrative standpoint, therefore, it is also favorable to disallow a deduction for contributions to an IRA, to treat earnings on an IRA as income, but to exclude the distributions therefrom from the section 467 computation.

April 20, 1984

Table 1. Estimated impact on New York State homeowners
Circuit breaker with differential income percentages for downstate/upstate, with residency requirement

	Income range	Total Number of Households in Category	Total Number of Households Eligible for Credits	Percent of Households in Category Eligible for Credits	Cost	Median Benefit	Mean Benefit	Maximum Benefit
Upstate	Less than $25,000	185,799	126,266	68%	147,851,021	830	1,171	11,143
	$25,000 to $50,000	293,033	124,609	43%	126,716,440	665	1,017	9,136
	$50,000 to $75,000	243,131	54,506	22%	67,331,078	1,029	1,235	7,840
	$75,000 to $100,000	161,829	27,208	17%	30,441,230	644	1,119	8,326
	$100,000 to $150,000	134,773	8,091	6%	14,170,377	1,113	1,751	12,546
	$150,000 to $200,000	32,598	534	2%	921,336	805	1,725	5,897
	$200,000 to $250,000	13,104	80	1%	11,948	149	149	149
	Over $250,000	16,160		0%				
	Total	**1,080,427**	**341,294**	**32%**	**387,443,430**	**791**	**1,135**	**12,546**
Downstate	Less than $25,000	70,368	60,262	86%	204,949,211	3,383	3,401	9,600
	$25,000 to $50,000	115,146	98,413	85%	284,170,510	2,721	2,888	8,760
	$50,000 to $75,000	134,188	104,828	78%	259,071,797	2,198	2,471	8,976
	$75,000 to $100,000	129,651	95,249	73%	180,400,901	1,754	1,894	7,441
	$100,000 to $150,000	169,104	66,093	39%	96,538,378	1,120	1,461	6,960
	$150,000 to $200,000	77,939	5,016	6%	5,202,441	758	1,037	3,523
	$200,000 to $250,000	32,755		0%				
	Over $250,000	56,344		0%				
	Total	**785,495**	**429,861**	**55%**	**1,030,333,238**	**2,113**	**2,397**	**9,600**
New York City	Less than $25,000	90,326	70,741	78%	106,998,082	1,224	1,513	6,874
	$25,000 to $50,000	126,257	62,366	49%	70,806,771	711	1,135	5,883
	$50,000 to $75,000	130,344	21,410	16%	30,655,155	1,068	1,432	4,808
	$75,000 to $100,000	99,234	9,302	9%	13,846,285	1,035	1,489	3,825
	$100,000 to $150,000	107,169	4,555	4%	3,919,825	816	861	2,439
	$150,000 to $200,000	47,850		0%				
	$200,000 to $250,000	19,223		0%				
	Over $250,000	43,745		0%				
	Total	**664,148**	**168,374**	**25%**	**226,226,118**	**917**	**1,344**	**6,874**
Total	Less than $25,000	346,493	257,269	74%	459,798,313	1,187	1,787	11,143
	$25,000 to $50,000	534,436	285,388	53%	481,693,721	1,019	1,688	9,136
	$50,000 to $75,000	507,663	180,744	36%	357,058,030	1,572	1,975	8,976
	$75,000 to $100,000	390,714	131,759	34%	224,688,417	1,422	1,705	8,326
	$100,000 to $150,000	411,046	78,739	19%	114,628,580	1,061	1,456	12,546
	$150,000 to $200,000	158,387	5,550	4%	6,123,777	805	1,103	5,897
	$200,000 to $250,000	65,082	80	0%	11,948	149	149	149
	Over $250,000	116,249		0%				
	Total	**2,530,070**	**939,529**	**37%**	**1,644,002,786**	**1,281**	**1,750**	**12,546**

NOTE: Analysis is based on microdata from the American Community Survey for 2006, released in 2007. Analysis excludes an estimated twenty thousand homeowners who reported less than $100 income for 2006.

Table 2. Estimated impact on New York State homeowners
Circuit breaker with differential income percentages for downstate/upstate, with no residency requirement

	Income range	Total Number of Households in Category	Total Number of Households Eligible for Credits	Percent of Households in Category Eligible for Credits	Cost	Median Benefit	Mean Benefit	Maximum Benefit
Upstate	Less than $25,000	278,351	187,635	67%	219,065,214	827	1,168	11,492
	$25,000 to $50,000	454,557	194,980	43%	197,153,420	663	1,011	9,588
	$50,000 to $75,000	380,982	87,025	23%	106,808,688	1,029	1,227	8,567
	$75,000 to $100,000	252,148	43,361	17%	44,462,183	595	1,025	8,326
	$100,000 to $150,000	206,830	11,469	6%	18,073,961	962	1,576	12,546
	$150,000 to $200,000	51,779	695	1%	1,502,191	964	2,161	5,897
	$200,000 to $250,000	20,290	80	0%	11,948	149	149	149
	Over $250,000	24,668		0%				
	Total	**1,669,605**	**525,245**	**31%**	**587,077,604**	**782**	**1,118**	**12,546**
Downstate	Less than $25,000	107,400	92,832	86%	313,457,787	3,353	3,377	10,199
	$25,000 to $50,000	179,314	150,301	84%	439,337,943	2,751	2,923	8,835
	$50,000 to $75,000	201,556	156,844	78%	382,988,912	2,184	2,442	8,976
	$75,000 to $100,000	200,739	145,720	73%	273,910,877	1,750	1,880	7,441
	$100,000 to $150,000	261,471	100,921	39%	149,874,712	1,120	1,485	7,283
	$150,000 to $200,000	121,860	7,400	6%	7,076,646	710	956	3,523
	$200,000 to $250,000	52,659		0%				
	Over $250,000	88,424		0%				
	Total	**1,213,423**	**654,018**	**54%**	**1,566,646,876**	**2,112**	**2,395**	**10,199**
New York City	Less than $25,000	139,015	107,266	77%	163,705,448	1,203	1,526	6,874
	$25,000 to $50,000	198,433	97,105	49%	115,542,607	724	1,190	5,887
	$50,000 to $75,000	198,225	31,778	16%	44,331,148	1,068	1,395	4,808
	$75,000 to $100,000	151,261	13,080	9%	18,854,631	934	1,441	3,825
	$100,000 to $150,000	172,451	7,084	4%	6,809,678	816	961	2,691
	$150,000 to $200,000	75,157		0%				
	$200,000 to $250,000	31,460		0%				
	Over $250,000	64,419		0%				
	Total	**1,030,421**	**256,313**	**25%**	**349,243,512**	**959**	**1,363**	**6,874**
Total	Less than $25,000	524,766	387,733	74%	696,228,449	1,201	1,796	11,492
	$25,000 to $50,000	832,304	442,386	53%	752,033,969	1,043	1,700	9,588
	$50,000 to $75,000	780,763	275,647	35%	534,128,748	1,564	1,938	8,976
	$75,000 to $100,000	604,148	202,161	33%	337,227,691	1,344	1,668	8,326
	$100,000 to $150,000	640,752	119,474	19%	174,758,352	1,061	1,463	12,546
	$150,000 to $200,000	248,796	8,095	3%	8,578,837	758	1,060	5,897
	$200,000 to $250,000	104,409	80	0%	11,948	149	149	149
	Over $250,000	177,511		0%				
	Total	**3,913,449**	**1,435,576**	**37%**	**2,502,967,992**	**1,277**	**1,744**	**12,546**

NOTE: Analysis is based on microdata from the American Community Survey for 2006, released in 2007. Analysis excludes an estimated twenty thousand homeowners who reported less than $100 income for 2006.