

# New York Has the Ways and Means: How and Why Wall Street Should Give Back to Main Street



A Report from the  
Center for Working Families  
and the  
Fiscal Policy Institute

April 2010



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April 2010

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## Executive Summary

New York families are in a terrible bind. Elected leaders, desperate to close huge budget gaps, have proposed deep cuts to the programs and services that are necessary for working families to thrive. Such cuts will be devastating, coming, as they do, on top of the series of blows dealt by the deep recession. The Great Recession has so far been marked by the loss of 350,000 jobs in New York State, record high unemployment of 850,000, and a staggering loss in wage income. Recession-slammed New York households daily stare down impossible choices: paying the utility bill or buying groceries; paying the mortgage or sending their kids to college.

**This report identifies other ways to balance the state's budget—sensible options that meet three goals:**

1. To support rather than undermine the needs of New York families.
2. To minimize the negative impact of this year's budget decisions on the fragile state economy.
3. To require the New York financial industry—which bears responsibility for much of the negative impact on the state's economy and finances since 2007, and which has now realized enormous profits because of the taxpayer-funded bailout—to contribute a fair share to Main Street's recovery.

## The Problem—Economic Context

- In New York, the Great Recession is hitting hardest at “Main Street,” with the loss of 295,000 moderate- and middle-wage jobs. That’s nearly five times the job loss in Wall Street’s finance sector.
- The recession has cost New York workers \$58 billion in lost wages as of the end of March 2010, and is on track to result in \$265 billion in lost wages through 2013.
- Over 100,000 New York families have lost homes through foreclosure in two years.
- The loss of jobs and wages has increased the number of New Yorkers relying on food stamps to over 2.5 million, a 40 percent increase during the past two years.
- While unemployment insurance provides a critical safety net, unemployment payments replace at most half of a worker’s previous wage. New York’s maximum weekly payment has been frozen at \$405 since 1999, lower than all neighboring states.
- New York’s small businesses are starved of credit access, and business bankruptcies are running three times higher than three years ago.

## The Problem—State Budget Gaps and Insufficient Revenues

Like the rest of the United States, New York continues to face the greatest budget shortfalls seen since the Great Depression of the 1930s. These deficits largely result from repeated tax cuts starting in 1994, coupled with a 29 percent plunge in personal income tax revenues following Wall Street’s meltdown. Essential services like fire departments and schools, recession-buffering social safety net programs like

homeless prevention and senior services, and critical infrastructure systems like hospitals, roads and mass transit all face severe cutbacks.

How did we get into such a bind? Analysis shows that state revenues would have grown faster than expenditures if:

- State policymakers had not enacted multi-year, back-loaded tax cuts from 1994 to 2000, and then again in 2006, or
- New revenues had accompanied new spending—from the original School Tax Relief (STAR) property tax exemptions to increased school aid following the successful Campaign for Fiscal Equity lawsuit.

Even with these new spending commitments, operating expenditures were lower as a percentage of the state's Gross Domestic Product in fiscal year 2008-2009 than in the decade before the tax-cutting spree of the 1990s.

Lieutenant Governor Richard Ravitch's long-term budget prepared at the Governor's request emphasizes balancing spending and revenues, not necessarily cutting. Given the importance of adequately funding critical public services and the infrastructure investments needed to sustain a highly productive economy, the state should be looking to progressive revenue options as well as ways to reasonably reduce spending.

### **Wall Street is an important part of the solution**

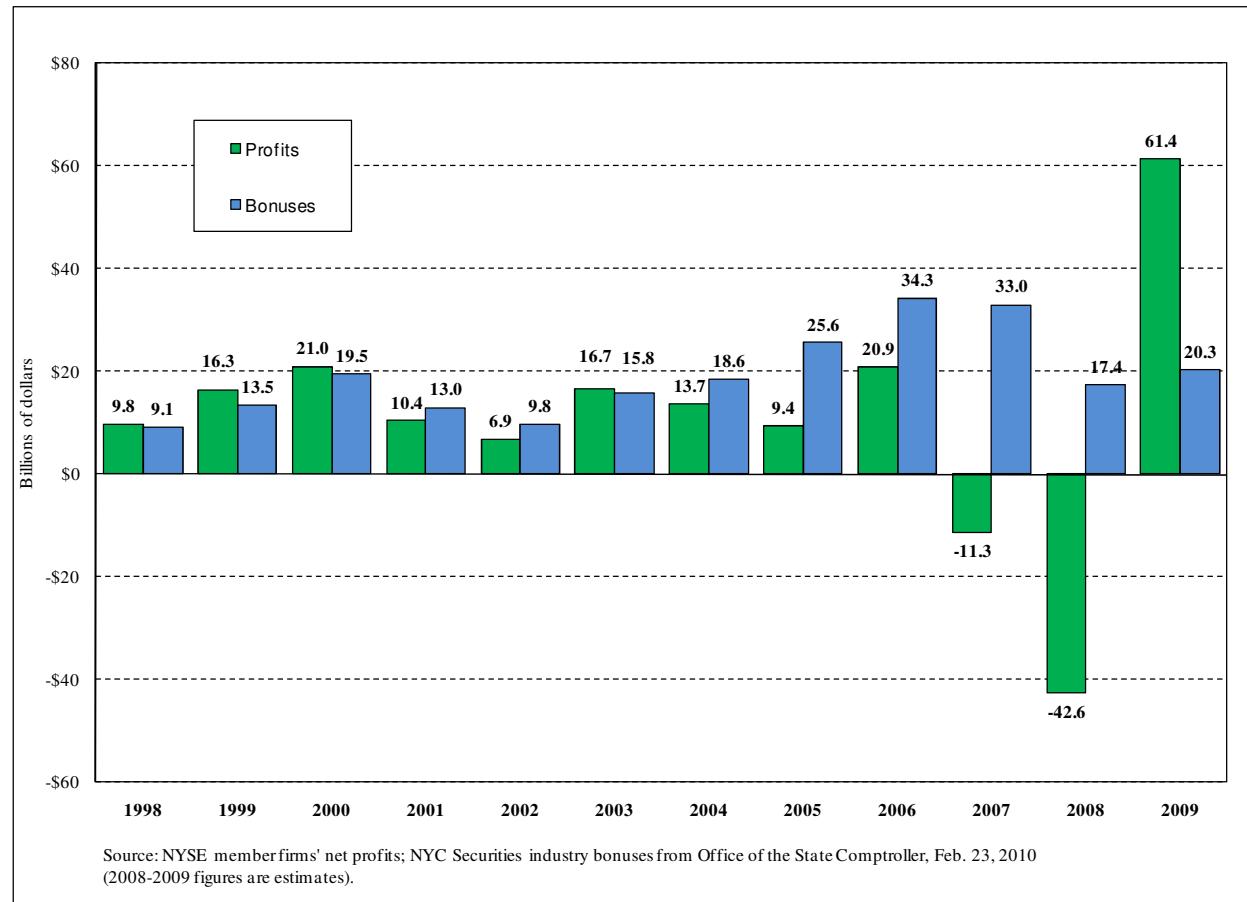
The financial meltdown was not an accident or a “hundred-year storm.” It resulted from a finance sector that strayed much too far from its traditional role in financing business operations and economic and job growth. Bad decisions made on Wall Street, with the acquiescence of inept regulators, wreaked havoc on the economy, bankrupted thousands of small businesses, and destroyed the livelihoods and took the homes of millions of Americans.

While Main Street is mired in the Great Recession, Wall Street has never done better. Thanks to generous taxpayer-funded bailouts and federal policies uniquely privileging the big banks with virtually free money, the financial industry posted record profits of more than \$61 billion in 2009, almost three times the previous record. These are truly windfall profits—as opposed to earnings from financing the recovery of American businesses. Never before has Wall Street made so much money from doing so little for economic and job growth.

The top twenty-five hedge fund managers were paid an average of \$1 billion each for 2009. The cash portion alone of 2009 New York City Wall Street bonuses is estimated at over \$20 billion—an average bonus of at least \$125,000, while the yearly salary for New York workers outside of finance is \$50,000.

Not only is Wall Street responsible for the Great Recession, it also has the resources needed for recovery. Wall Street must be part of the solution to Main Street’s problems.

## Wall Street Profits surged to over \$61 billion in 2009, three times the previous record



## The Solution: A four-part action plan

To address the current recession's challenges while moving New York toward a sensible long-term balance between spending and revenues, a four-part action plan of temporary and permanent measures is needed.

### ***I—Enact temporary tax measures that recapture some of Wall Street's profit windfall to spur Main Street's recovery.***

Given Wall Street's extraordinary 2009 profits underwritten in full by a taxpayer bailout, New York's financial industry is well-positioned to help bring fiscal stability to the state, and tax relief and basic fairness to working New Yorkers. Some mix of the following four options should be considered, with a goal of raising \$6 billion per year for two years.

- **Temporary bonus recapture tax.** A modified version of the U.K. bonus tax, the New York plan will levy a payroll tax on bonuses worth at least \$50,000 and paid to employees receiving total annual compensation of \$250,000 or more. The tax should start at 25 percent of eligible bonuses, and reach 50 percent when total compensation passes \$500,000. The tax

is structured as a temporary tax on all bonus compensation, including deferred bonuses whether paid as cash, stock, or stock options.

- **Temporary reduction of Stock Transfer Tax rebates.** New York has had a stock transfer tax on the books since 1905, but the state has returned it through an automatic 100 percent rebate since 1981. Last year, the value of stock transfer rebates was \$14.5 billion. Retaining just 20 percent of the rebate would have generated revenue of \$2.9 billion. A temporary reduction of the rebate will not trigger an exodus of financial firms—and it will provide a major source of revenue.
- **Suspension of the carry-forward provision for 2007 and 2008 net operating losses for financial firms.** This measure will suspend the ability of large firms to reduce their New York corporate income tax liability on profits in 2009 or future years based on losses in 2007 or 2008. Those losses have been more than made up by 2009's record profits, thanks to the taxpayer bailouts and low Federal Reserve interest rates.
- **Windfall profits tax.** Wall Street's largest banks posted record profits in 2009—entirely as a result of government economic policies and taxpayer resources. At the same time, Main Street New York businesses are starved for capital, and still mired in the “Great Recession.” A one-time windfall tax should be levied on financial firms whose profits exceed a certain threshold for 2009 and 2010.

## ***II—Close loopholes and reform New York’s tax system to make it fairer and more effective.***

State tax loopholes and credits to big businesses, and financial firms in particular, siphon away hundreds of millions of dollars yearly, with very little return for taxpayers. New York should right the balance by reclaiming a fair share of taxes from business and reducing the tax burden on households. Under New York’s state and local tax system, low- and middle-income families contribute greater shares of family income to support government services than wealthier taxpayers. Reforms to property taxes, personal income taxes and corporate taxes can make the system fairer and more productive.

- The state’s **taxation of financial firms** should be updated to respond to several changes in the industry’s structure and practices, and enact reforms that will generate ongoing annual revenues of more than \$300 million. The state should also seriously consider placing a temporary cap on corporate tax credits, which have grown in recent years to a cost of \$4.5 billion.
- New York State should reform its **personal income tax** structure to increase the progressivity of that tax on a permanent basis while providing the revenue necessary to reduce the pressure that is currently placed on local property and sales tax bases, and to meet New York’s pressing budget needs on a recurring and sustainable basis.

## ***III—Support federal action to counter the recession and modernize state corporate income taxation.***

New York government, labor, business and civic leaders should work with their counterparts in other states and at the national level to secure a much-needed extension of state fiscal relief; fund a robust job creation package; and repeal the federal law that prohibits states from drawing income tax from corporations whose profits are based on New York sales but who do not have property or employees in New York.

#### ***IV—Give Main Street the help it needs.***

The short-term revenues raised by the above recommendations should be used to help close the state's recession-driven budget gaps and to begin the phase-in of a meaningful and well-targeted property tax "circuit breaker."

The revenues from the permanent tax reforms and cost savings measures should be used to restore the state's budget to structural balance while meeting the state's important service commitments and funding a property tax circuit breaker on an ongoing basis.

New York State's budget gaps should be closed in ways that foster fairness, sustained recovery and broadly shared prosperity. In helping Main Street, it is essential that New York State keep the following objectives at the top of its priority list in both the short run and the long run:

- Restoring state aid to localities to reduce local tax burdens.
- Funding essential services and programs in the state budget.
- Investing in the state's physical infrastructure, including mass transportation, to create jobs and put New York workers back to work while maintaining the foundation for a prosperous New York.



# New York Has the Ways and Means

How and Why Wall Street Should Give Back to Main Street

## The Economic Context

### **While Wall Street reaps record windfall profits, “Main Street” New York suffers from the Great Recession**

New York families are in a terrible bind. Elected leaders, desperate to close huge budget gaps, have proposed deep cuts to the programs and services that allow working families to thrive. Such cuts will be devastating, on top of a series of blows dealt by the deep recession. The current economic crisis—marked by the loss of 350,000 jobs in New York State and the highest unemployment rate in decades—is overwhelming low and middle-income families and jeopardizing essential government services. Recession-slapped New York households daily stare down impossible choices: buying heating fuel or groceries; paying the mortgage or sending their kids to college.

At the same time, New York faces a \$9 billion deficit this year, and still larger deficits next year and the year after.<sup>1</sup> These deficits began as sizable budget holes resulting from the long-term, repeated tax cuts of the last two decades. The plunge in tax revenues in the wake of Wall Street’s September 2008 meltdown has now rendered them catastrophic. Essential services like fire departments and schools, recession-buffering social safety net programs like homeless prevention and senior services, and critical infrastructure systems like hospitals, roads and mass transit all face severe cutbacks.

But Wall Street is not suffering from the budget catastrophe or from the crash. Thanks to generous taxpayer-funded cash bailouts, subsidies, and guarantees, and federal policies uniquely privileging the big banks with virtually free money, the financial industry rang up \$61.4 billion in profits for 2009 alone—that is nearly *triple* Wall Street’s previous record. These are truly windfall profits—they are courtesy of the taxpayer-funded bailout and not because the big banks made money from financing the recovery of American businesses. Never before has Wall Street made so much money from doing so little for economic and job growth.

### **New York’s families, the state’s most critical economic resource, are in deep long-term trouble**

The Great Recession, which began at the end of 2007 at the national level, is already the longest and deepest recession since the 1930s. The recession started slightly later in New York—in the spring of 2008—but the drop in total wages and incomes has been greater here, and job losses over the past two years have hit hardest at sectors employing moderate- and middle-income workers.<sup>2</sup> Most economists expect the pace of growth to be so modest that unemployment will remain quite high for some time.

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<sup>1</sup> The projected out-year deficits are based on the assumption that the state’s finances will recover very slowly. To the extent that the state closes this year’s budget gap with recurring actions, projected budget gaps for future years will be smaller.

<sup>2</sup> Fiscal Policy Institute, “New York State’s Economic and Fiscal Outlook for 2010-2011,” Feb. 3, 2010.

The New York State Division of Budget does not expect jobs to reach pre-recession levels until 2014 at the earliest—meaning that in New York unemployment rates will remain elevated for three to four more years, on top of the two years of recession already past. The numbers paint a staggeringly grim picture:

- 850,000 New Yorkers are unemployed, the highest number on record, and 40 percent of them have been out of work for over six months. One in six has been jobless for more than a year.<sup>3</sup> New Yorkers are still losing jobs in large numbers. Each week during the first three months of 2010, an average of 30,000 workers filed initial claims for unemployment.
- New York has lost 350,000 jobs over the past two years, with the loss of 295,000 moderate- and middle-wage jobs, nearly five times as great as the finance sector employment losses. (The severity of the Great Recession would have claimed another 193,000 New York jobs as of March 2010, according to the President’s Council of Economic Advisers, were it not for the \$800 billion February 2009 stimulus package, the American Recovery and Reinvestment Act.<sup>4</sup>)
- The recession has cost New York’s workers \$58 billion in lost wages as of the end of March 2010, and is on track to result in a total of \$265 billion in lost wages through the end of 2013.<sup>5</sup>
- The official state unemployment rate stands at 8.6 percent, and the underemployment rate—often called the “real” unemployment rate—is now nearly 15 percent.<sup>6</sup>
- Over 100,000 New York families have lost their homes through foreclosure in the past two years, saddling families with the high costs of motels and other temporary housing, disrupting children’s schooling, and often resulting in long-term housing insecurity.
- The loss of jobs and wages has increased the number of New Yorkers relying on food stamps to over 2.5 million, a 40 percent increase during the past two years.
- While unemployment insurance provides a critical safety net for people losing jobs, unemployment insurance payments replace at most half of an unemployed worker’s previous wage. New York’s maximum weekly unemployment payment has been frozen at \$405 since 1999, a lower level than all neighboring states.<sup>7</sup>
- Credit remains highly inaccessible for New York’s small businesses, and business bankruptcy rates are running three times higher than three years ago.<sup>8</sup>

By contrast, the top twenty-five hedge fund managers took home an average of \$1 billion each for 2009.<sup>9</sup> The cash portion of 2009 bonuses is estimated at \$20.3 billion in the New York City securities sector alone. That amounts to an average cash bonus of at least \$125,000 per employee, while the average yearly salary for the rest of New York City is \$50,000.

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<sup>3</sup> Fiscal Policy Institute, “New York’s Unemployment Crisis,” March 2010.

<sup>4</sup> Executive Office of the President, Council of Economic Advisers, “The Economic Impact of the American Recovery and Reinvestment Act of 2009, Third Quarterly Report,” April 14, 2010, supplement.

<sup>5</sup> This estimate excludes the wages of finance sector workers, and assumes that total non-finance wages would have grown by 4.5 percent a year in the absence of the recession. This was the average growth for the five years from 2002 to 2007. Estimates by the Fiscal Policy Institute, April 2010.

<sup>6</sup> The underemployment rate—14.6 percent for the state and 17 percent for New York City—also counts those who have only been able to find part-time work although they are seeking full-time jobs, and those who have dropped out of the labor market due to long-term discouragement.

<sup>7</sup> Fiscal Policy Institute and National Employment Law Project, “Albany Inaction Costs Jobless New Yorkers \$267 Million,” July 2, 2009. New York’s wage replacement rate ranks near the bottom among all 50 states.

<sup>8</sup> Fiscal Policy Institute, “New York State’s Economic and Fiscal Outlook for 2010-2011,” Feb. 3, 2010.

<sup>9</sup> “Hedge Fund Manager’s Pay Roars Back,” *New York Times*, April 1, 2010.

## Wall Street's Responsibility

### The Great Recession: Made on Wall Street

The Great Recession is mainly the consequence of poorly regulated financial institutions that went on a spree of excessive debt and risk-taking, destructive lending practices, and use of ill-advised exotic financial instruments. The national economic expansion following the economy's slump from 2001 to 2003 was dominated by unsustainable and dangerous bubbles in housing and the financial markets. It was also characterized by excessive borrowing by Americans struggling to maintain their standard of living while their real wages fell.<sup>10</sup>

New Yorkers know the story all too well: In 2007, the financial markets suddenly faltered, revealing that Wall Street firms controlling more than \$10 trillion in assets had taken huge risks and traded in "toxic" securitized mortgages and derivatives to pump up profits. By fall 2008, worldwide credit markets were frozen and the stock market was in freefall, eroding working families' retirement savings and pension funds, and triggering massive job cuts across New York. In the wake of the meltdown, consumer spending plummeted and small business loans virtually disappeared. The triple impact of stagnant wages, record income inequality, and the jobless "recovery" is now wreaking havoc on New Yorkers.<sup>11</sup>

In the wake of the 2008 financial meltdown, aggressive measures were taken by the Federal Reserve, the U.S. Treasury Department, and the Federal Deposit Insurance Corporation. The federal government spent hundreds of billions of taxpayer dollars, allowed massive borrowing by the largest financial institutions from the Federal Reserve at zero or near-zero interest, and provided guarantees on money market deposits and bank debt. The multiple programs created and deployed by the government after the financial industry meltdown (of which the \$700 billion Troubled Asset Recovery Program, or TARP, is only one), add up to trillions of dollars of subsidies for Wall Street paid by regular taxpayers.

### The Public Safety Net—for Wall Street

Just as important as TARP was the \$600 billion in unconventional rescue actions taken by the Federal Reserve, beginning in March of 2008, at the time Bear Stearns was taken over by JP Morgan Chase. The rescue actions expanded rapidly in the fall of 2008, beginning with the Federal Reserve's \$85 billion initial infusion of funds into AIG.<sup>12</sup> These unorthodox measures included extending the Federal Reserve's credit to major Wall Street operations (usually in exchange for toxic assets of questionable value), and establishing special-purpose funding facilities to support money market mutual funds and to restart commercial paper lending until major financial institutions were sufficiently recovered to resume that function. The Federal Reserve also bought over \$1 trillion in mortgages to keep long-term interest rates low and to bolster the market for mortgage-backed securities and derivatives related to the mortgage

<sup>10</sup> For an incisive discussion of the finance sector's role in causing the Great Recession and an examination of why the taxpayer-funded bailout has failed to generate an economic recovery, see Joseph Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy*, New York: W. W. Norton, 2010.

<sup>11</sup> Fiscal Policy Institute, *The State of Working New York 2009: Unemployment and Economic Insecurity in the Great Recession*, September 2009.

<sup>12</sup> AIG eventually received \$180 billion in federal aid. Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, New York: Pantheon Books, 2010.

market, which provided indirect support for the hundreds of billions in toxic assets on the books of the big banks.

As economists at the Federal Reserve Bank of Richmond have shown, by December 2008, the safety net created to save big banks (including both explicit and implicit guarantees) made taxpayers answerable for 92 percent of the total liabilities of the nation's banking system (\$14 trillion out of \$15.2 trillion in liabilities were guaranteed). And this does not count the \$800 billion in AIG liabilities that also came under the protection of the federal safety net.<sup>13</sup>

During the financial meltdown, the largest banks had effectively failed when they stopped lending to each other. No one would value the toxic assets the banks had saddled themselves with any longer, and thus no bank had sufficient collateral against which they could borrow. Federal emergency actions of unprecedented scale resurrected the largest banks. At the same time, the Federal Reserve applied the usual anti-recession tonic of low interest rates (zero percent to one quarter of a percent) in the hopes of bringing the economy back to life. However, the severity of the job losses and business failures wrought by the collapse of the intertwined financial/housing bubble severely constrained the capacity of the economy to bounce back, even with the lowest of interest rates.

But the big banks benefited enormously. They proceeded to borrow billions at rock-bottom interest rates to finance the purchases of Treasury bonds that paid interest several times greater than the cost of the initial funds. They also pumped borrowed funds into the stock market, and profited from a market rebounding from the worst crash since 1929. Under those circumstances—virtually free money available in enormous quantities to buy bonds paying a higher rate or stocks offering returns of five, ten, twenty percent or higher in a stock market rising from a trough, and backed by a federal guarantee—just about anyone could have raked in billions of dollars in profits given such advantages. But those terms were only available to firms considered “too big to fail.”<sup>14</sup>

## Wall Street’s Windfall Profits in the Midst of Main Street’s Great Recession

Even during a period in which more than eight million jobs were destroyed around the country, millions of Americans lost their homes, tens of thousands of family businesses went under, and over 25 million Americans were jobless or working for less, the biggest Wall Street banks claimed over \$61 billion in profits in 2009. This was three times the previous record haul, and greater than the total profits amassed during the four years from 2003 to 2006 when the housing and subprime bubbles were being inflated.

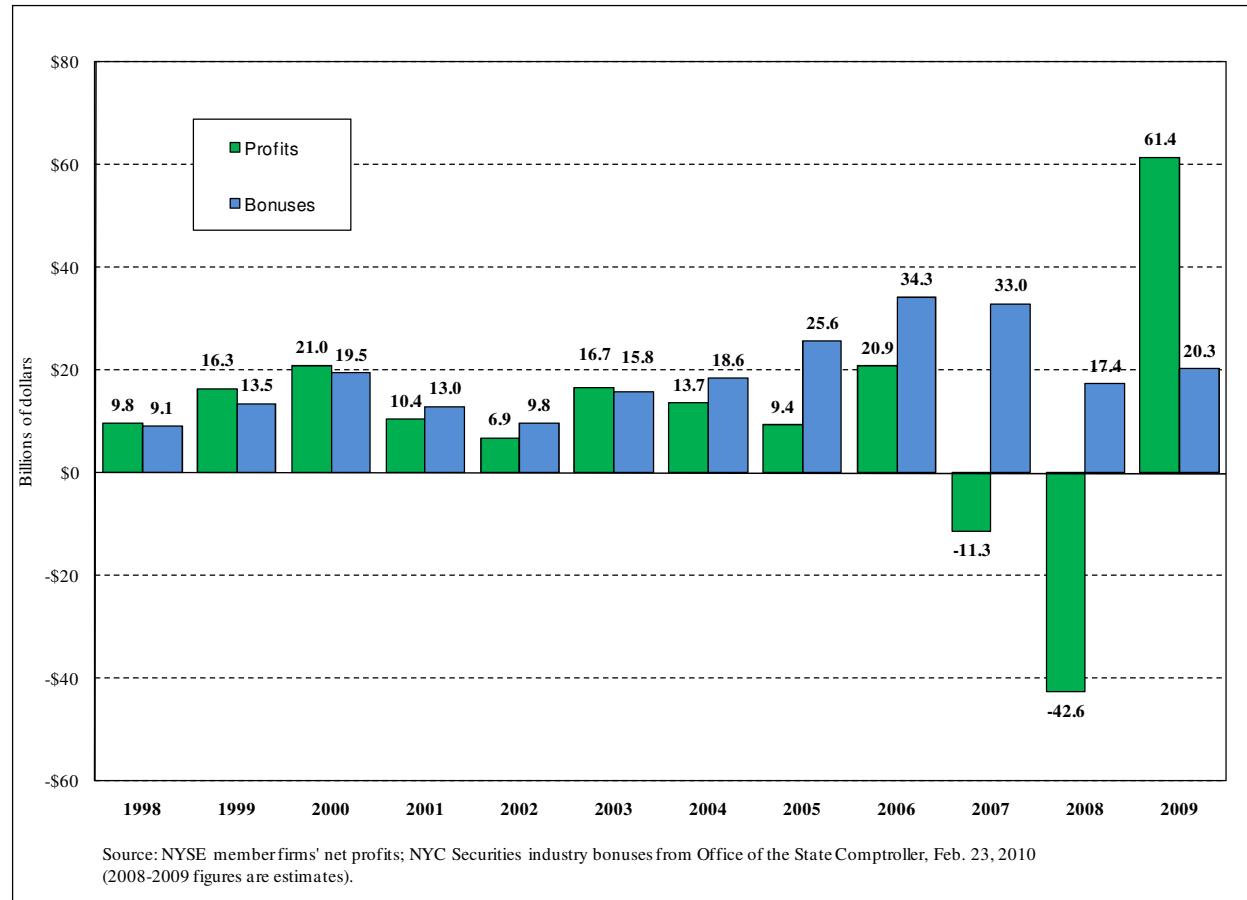
Wall Street profits like those generated in 2009 did not come about by manufacturing goods, delivering services, or selling those goods and services the way most corporations make profits. Wall Street’s 2009 profits also did not result from financing business expansion, new startup companies, or job creation. Those profits are simply windfall profits. They were a gift from the taxpayer, arranged by the Federal Reserve and the Treasury with the expectation that banks would use the gift to spark a real economic recovery, putting people back to work, restoring consumer spending power, and easing the foreclosure crisis. That expectation has not been met.

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<sup>13</sup> Nadezhda Malysheva and John R. Walter, “How Large Has the Federal Financial Safety Net Become?” Federal Reserve Bank of Richmond, March 2010.

<sup>14</sup> Stiglitz, *Freefall*, and Johnson and Kwak, *13 Bankers*.

## Wall Street Profits surged to over \$61 billion in 2009, three times the previous record



Despite having pushed the economy and millions of American families into financial ruin, bankers have granted themselves and their traders over \$20 billion in cash bonuses for 2009 and unknown billions more in stock options. Were it not for a growing public uproar, cash bonuses might have approached the record levels of 2006 and 2007. A group of employees totaling about 2 percent of New York's workforce is reaping these payouts of \$20 billion on top of their salaries—worth more than double the amount of New York State's budget gap—and still more in deferred bonuses.

## New York's budget crisis is Wall Street-driven, but we're leaning hard on Main Street to fill the gap

### New York's budget gap results from plummeting tax revenues

Like the rest of the United States, New York continues to face its greatest shortfalls since the Great Depression of the 1930s. Some critics claim that New York State's budget gap is proof that "spending is out of control." But analysis shows that revenues would have grown faster than expenditures if the state had not enacted multi-year, back-loaded tax cuts annually from 1994 to 2000, and then again in 2006.<sup>15</sup> Also, if important new spending commitments—from the original STAR property tax exemptions enacted in 1997 to the increased school aid following the successful Campaign for Fiscal Equity lawsuit over education funding—were accompanied by new revenues, deficits would be much smaller.<sup>16</sup>

These commitments added several billion dollars to state expenses. Public spending commitments are often broadly supported by the public, but by failing to add revenue, the state increases the likelihood of structural deficits. This year's budget projects that current revenues will not grow fast enough to cover ordinary growth and new commitments.

However, even with these new spending commitments,<sup>17</sup> New York State's operating expenditures were lower in fiscal year 2008-2009 as a percentage of the state's Gross Domestic Product—the total value added by production in the state economy—than in the decade before the tax-cutting spree of the 1990s.<sup>18</sup>

State government revenues have declined precipitously with the recession. Between 2008 and 2010, the state budget office's projection of personal income tax revenues for the 2010-2011 fiscal year fell by 29 percent.<sup>19</sup> This \$12.8 billion loss is only partially offset by \$5.5 billion projected to be received in 2010-2011 from progressive tax changes passed in 2009. Sales tax collections dropped by seven percent in the 12 months following the September 2008 meltdown, severely affecting local government finances.

### New York already places heavier burdens on moderate and low-income taxpayers

In the current fiscal crisis, the state is set to slash budget items that provide low- and moderate-income New Yorkers with stability and opportunity, while financial firms and their wealthiest employees bank their recession-made windfall gains. But low-, moderate- and middle-income New Yorkers already shoulder the state's burden, paying a higher share of family income in state and local taxes than the wealthiest one percent of New York's families whose incomes start at \$633,000.<sup>20</sup> While the state's

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<sup>15</sup> Tax cuts enacted between 1994 and 2006 reduced state tax revenues by about \$20 billion in 2008-2009. See p. 42, Fiscal Policy Institute, "Balancing New York State's 2009-2010 Budget in an Economically Sensible Manner," January 2009.

<sup>16</sup> For additional discussion of these new spending commitments, see Fiscal Policy Institute, "Balancing the New York State Budget in an Economically Sensible Manner," March 2010.

<sup>17</sup> Except for STAR which is a tax reduction.

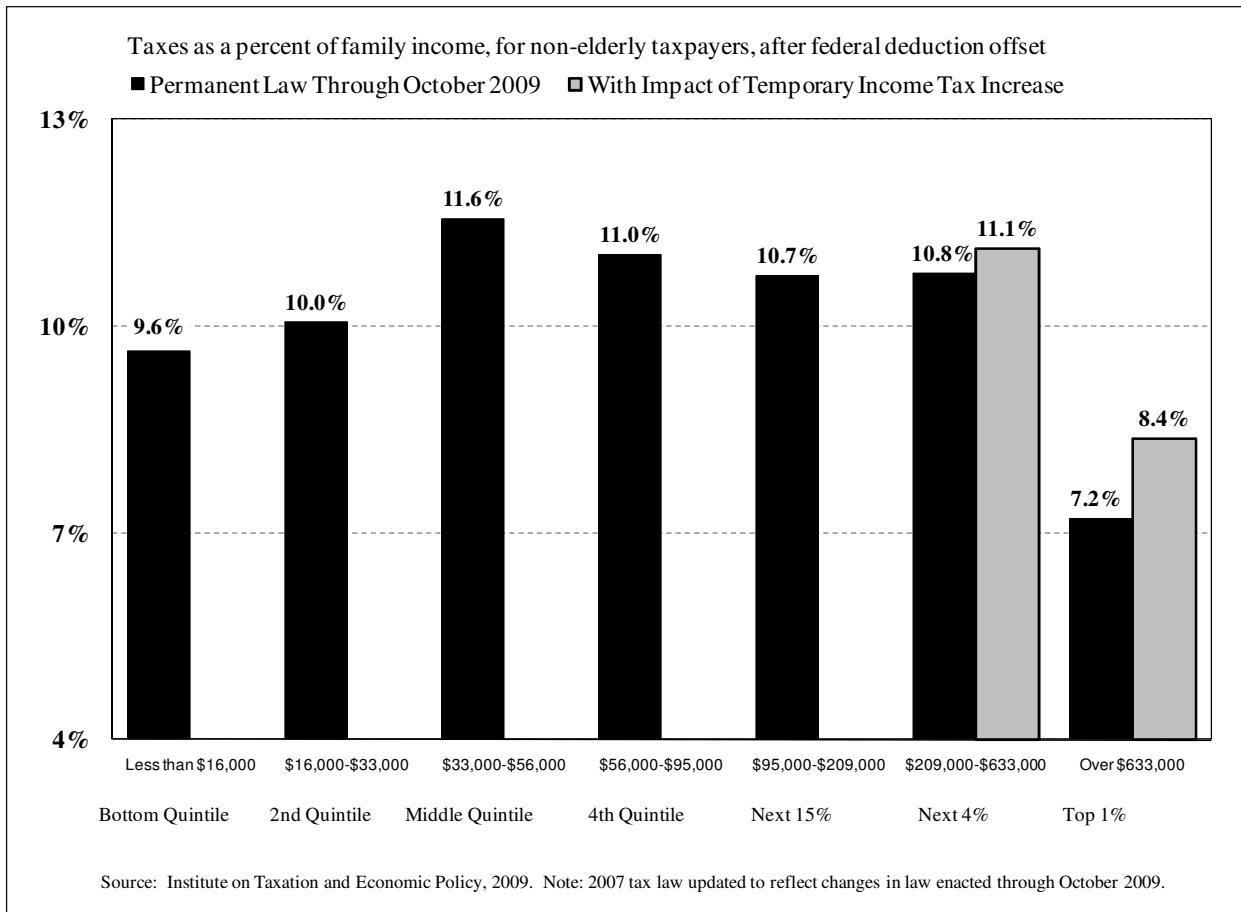
<sup>18</sup> See Fiscal Policy Institute, "New York State's Economic and Fiscal Outlook for 2010-2011," February 2010, p. 33.

<sup>19</sup> Excluding the impact of the high-end personal income tax increases enacted in April 2009, in January 2008 the budget office projected PIT revenues of \$44.5 billion for the 2010-2011 fiscal year, and by January 2010, the projection for the 2010-2011 fiscal year had been lowered to \$31.7 billion.

<sup>20</sup> This analysis includes a federal deduction offset and the impact of the NYS personal income tax changes enacted in the spring of 2009.

personal income tax is mildly progressive, New York's property and sales taxes are highly regressive, meaning that middle and lower income households pay higher rates relative to their incomes than high-income households.<sup>21</sup>

Overall, the wealthiest one percent of households pay a much smaller share of their income in state and local taxes than do all other New Yorkers, even with the temporary income tax increase.



In the most recent economic expansion, income gains were highly concentrated in the hands of a small portion of the state's population.

- The top five percent of New York households received nearly three quarters of the total income growth recorded in New York State between 2002 and 2007.
- The total income of the top five percent grew more than four times as fast as the total income of the other 95 percent.
- The wealthiest five percent now have an aggregate income equal to that of the bottom 95 percent.<sup>22</sup>

<sup>21</sup> See the table in the Appendix for a breakdown by tax for each income group.

## New York should balance expenditures—and burdens—with long-term revenue-generators

Lieutenant Governor Richard Ravitch has argued forcefully for establishing a long-term recurring balance between state expenditures and revenues.<sup>23</sup> He notes that the state's structural budget gap would be more than \$13 billion without the impact of the recession (both the negative impact of depressed revenues and the help of federal stimulus funds). That is, even without the recession, New York State would be facing a serious deficit due to a structural misalignment between revenues and expenditures.

If the state adopts some variation of Ravitch's proposal, it will be significantly harder to assume new spending commitments without identifying revenues to pay for them. By the same token, a tighter budget discipline should also require consideration of the affordability and sustainability of proposed tax cuts. Tax cut proposals should be subject to a more thorough debate and careful thought would have to be given to how to pay for any loss in revenues.

In addition to the multi-year income tax cuts discussed above, New York has adopted twelve business tax credits in the past three years, bringing the total to 36 business credits. The annual value of these credits has skyrocketed from less than \$200 million in 1994 to over \$1.2 billion in 2008. In addition, there are an enormous number of "carry forward" tax credits for businesses —well over \$2 billion worth—that could be used to further reduce future tax liability and lessen tax collections.

The Ravitch plan emphasizes balancing spending and revenues, not necessarily cutting. Given the importance of adequately funding critical public services and the infrastructure investments needed to sustain a highly productive economy, New York State should be looking to progressive revenue options as well as ways the state can reasonably reduce spending and achieve budget savings.

The Better Choice Budget Campaign has identified several proposals that should be considered to help the state close its budget gap. These include the following:

- Closing loopholes that allow large, profitable corporations to avoid paying their fair share of state taxes;
- Reducing the amount of state work that is contracted out to for-profit consultants that state workers can do better for less cost;
- Lowering state and local government prescription drug expenditures by using New York's considerable purchasing power from its EPIC, Medicaid and public employee health insurance programs to negotiate fair deals with pharmaceutical suppliers;
- Making economic development/tax credit programs like Industrial Development Agencies (IDAs) and the Brownfield Clean-up program more effective and accountable and allowing the Empire Zones Program to expire;
- Helping the environment and reducing landfill costs by instituting a minimal plastic bag tax to reduce the use of 6.3 billion bags in New York State each year; and
- Ensuring that cigarette sales to non-Native Americans on Native American reservations are properly taxed by collecting those taxes before the products reach the reservations.<sup>24</sup>

<sup>22</sup> Fiscal Policy Institute, "New York State's Economic and Fiscal Outlook for 2010-2011," February 2010, p. 42.

<sup>23</sup> Lieutenant Governor Richard Ravitch, "A Five-Year Plan to Address the New York State Budget Deficit," March 10, 2010.

<sup>24</sup> For details on these and other gap-closing proposals, see Better Choice Budget Campaign, "Revenue-Raising and Cost-Saving Options," February 22, 2010, <http://www.abetterchoicefory.org/BCBCOptionsChart22Feb2010.pdf>.

The following section lays out our four-point action plan to support Main Street and reach a balanced budget.

## A plan to balance the New York State budget—but not on the backs of working families

A failure to invest in the state's future is exacting a heavy price on the state's human and physical infrastructure. To address important budget needs, and to avoid harmful budget cuts advanced by the governor, state policymakers should make the tax system fairer and raise the revenue necessary to balance the budget in an economically sensible manner.

New York State should balance its budget in ways that will improve rather than worsen economic conditions during the current downturn. The governor and members of the state Legislature should draw on the budget balancing strategies of 2003 and 2009, which avoided the negative impact of budget actions in the early 1990s.

To address the current challenges of the recession and dangerously falling incomes while moving New York toward a sensible long-term balance between spending and revenues, both temporary and permanent measures are needed.

We propose a four-part action plan:

- I. Enact temporary measures that use Wall Street's windfall to spur Main Street's recovery.
- II. Close loopholes and reform New York's tax system to make it fairer and more effective.
- III. Support federal action for more fiscal relief, job creation, and to ensure fair corporate taxation.
- IV. Give Main Street the help it needs.

## I. Enact temporary tax measures that recapture some of Wall Street's profit windfall to spur Main Street's recovery

Given Wall Street's extraordinary 2009 profits, New York's financial industry is well-positioned to bring fiscal stability to the state, and tax relief and basic fairness to working New Yorkers. Taxpayers came to the rescue when Wall Street imploded. Now, Wall Street needs to contribute to solving the state fiscal challenges and repay taxpayers for their contributions to firms' and individuals' wealth.

Four options should be considered for recapturing windfall profits from the financial industry, with a goal of raising \$6 billion a year for two years.

**Temporary bonus recapture tax.** The New York plan will levy a payroll tax on bonuses worth at least \$50,000 and paid to employees receiving total annual compensation of \$250,000 or more. The tax should start at 25 percent of eligible bonuses and reach 50 percent when total compensation passes \$500,000.

The tax should be structured as a temporary tax on all bonus compensation awarded, for a maximum of two bonus seasons, including deferred bonuses paid as deferred cash, stock, or stock options. This ensures against firms attempting to evade the tax by switching forms of compensation and also collects revenues on the true value of super-bonuses. See "A Windfall Bonus Recapture Tax Plan: The Mechanics" on page 18 for more detail. **Projected year-end bonus cash revenue: \$4.7-6.9 billion per year.<sup>25</sup> Total revenues from deferred bonus compensation will likely double these year-end revenues.**

**Temporary reduction of Stock Transfer Tax rebates.** New York State's stock transfer tax does not need to be reinstated—it's still on the books. But the state gives it away as an immediate and automatic 100 percent rebate. The state began rebating the tax in 1979 at 30 percent, in 1980 at 60 percent, and in 1981 at 100 percent.

Last year, the value of New York's Stock Transfer Tax rebates was \$14.5 billion. Rebalancing the rebate to an 80/20 split (just 20 percent retained by the state) would have resulted in \$2.9 billion in additional revenue last year.

The Stock Transfer Tax rebate is often considered untouchable: New Jersey and Connecticut do not tax stock transactions, and the computers used for exchange transactions might easily be moved out of New York State in response to a tax that very slightly reduces trading profits.<sup>26</sup> But a temporary reduction of the rebate will not trigger an exodus of financial firms—and it will provide a major source of revenue.

Reducing the rebate for a period of two years will also tie the tax to the financial crisis. The tax can be made progressive, and deter speculation, if linked to trading volume—the lower the trading volume, the lower the tax. **Projected two-year revenue: \$4 to 6 billion.**

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<sup>25</sup> This estimate reflects year-end cash bonuses for the 2009-2010 bonus season.

<sup>26</sup> The stock transfer taxes 5 cents per share on traded shares worth more than twenty dollars and less on shares trading for less than twenty dollars a share. The temporary reduction of the rebate would mean New York State would keep between one quarter cent and one cent of the rebate on each share traded.

**Suspension of the carry-forward provision for 2007 and 2008 net operating losses for financial firms.** This measure will suspend the ability of large firms to reduce their New York corporate income tax liability on profits in 2009 or future years based on losses in 2007 or 2008 (whether they pay under the Business Corporation Franchise Tax or the Bank Corporation Franchise Tax). Current state law allows corporations to carry net operating losses (NOL) back two years or forward 20 years. The carry-back provision is limited to \$10,000, but there is no limit on the amount of net operating losses that can be carried forward.

Many major financial corporations had large losses in 2008 (and some had losses in 2007), but the same financial firms have handily made up those losses in 2009, and made record gains as well. Since the 2007 and 2008 losses sustained by major financial corporations were offset by several federal financial bailout actions (not only restoring losses, but generating unprecedented profits) they should not be allowed to reduce their New York corporate income tax liability based on those recorded losses.

If the carry-forward provision is not changed, firms will be able to substantially limit their New York State corporate income tax liability on 2009's taxpayer-subsidized profits and in future years.

**Projected overall revenue: \$300-400 million.**

**Windfall profits tax.** In a broader business environment characterized as the “Great Recession” with very high and long-term unemployment, very little lending to small- and medium-sized companies, and high incidence of bankruptcies, it is unfathomable that the largest financial corporations could have “earned” record profits in 2009—these profits were entirely a consequence of government economic policies and taxpayer resources.

A simple one-time windfall tax can be levied on firms whose profits exceed a certain threshold for 2009 and 2010. Since financial firms have fared far better than any others this year, the threshold can be set to target those firms. Taxing company earnings of large financial firms’ excess profits above some reasonable level in 2009 and 2010 is a sensible approach. As discussed above, suspension of the carry-forward provision for 2007 and 2008 net operating losses is necessary to effectively target windfall profits and realize the revenues from this tax. **One-time revenue: amount depends on parameters of the tax.**

## A Windfall Bonus Recapture Tax Plan: The Mechanics

To recover a modest portion of Wall Street's bailout profits for Main Street, a temporary Bonus Recapture Tax measure should apply to all bonus compensation—both year-end cash payouts and deferred awards. Year-end cash bonuses for the 2009-2010 bonus season are estimated at \$20.3 billion<sup>27</sup> or more, paid to approximately 150,000 employees. The temporary bonus recapture tax plan will generate an estimated \$4.7-6.9 billion in revenues. This represents roughly 10 percent of the financial industry's 2009 record profits.

<b>What is taxed:</b> Bonuses higher than \$50,000 that are awarded to individuals who receive more than \$250,000 in total compensation.	Total compensation accounts for both salary and bonuses received. The tax itself is only levied on the bonus, not the salary portion of total compensation.
	Bonuses over \$50,000 awarded to employees who received \$250,000 or more in total compensation will be taxed using a graduated rate from 25 percent, reaching to 50 percent of bonus when total compensation passes \$500,000.
	Deferred compensation will be taxed at the same rates (but the \$50,000 threshold would not apply if it was already applied to the year-end cash bonus).
<b>How it is collected:</b> As a payroll tax.	The tax will be collected as a payroll tax from the firms awarding the bonuses. As a payroll tax, it will be collected at the institutional level, not at the individual level. The amount of any bonus received by an employee and would be taxed as regular income.
<b>Time period:</b> Temporary tax, for a maximum of two calendar years.	The tax will be temporary and cover at least an entire bonus season (which overlap calendar years) to ensure bonus payouts are not simply pushed forward past the measure's sunset. A retroactive component for the 2009-2010 bonus season is important to recover taxpayer monies resulting in 2009's record profit year.
<b>Preliminary Estimates of Net Revenue: \$4.7b-\$6.9 billion from cash bonuses.<sup>28</sup></b> Eventual revenues from deferred compensation will likely match or exceed than cash bonus revenues.	

<sup>27</sup> The Office of the State Comptroller's most recent bonus pool estimate only reflects cash bonuses for securities industry firms in New York City. It does not reflect other sectors of the financial industry, the rest of the state, or deferred comp/stock options (unless taxes were pre-paid).

<sup>28</sup> Bonus estimate sources reflect the 2009-2010 bonus season and include the NYS Office of the State Comptroller, NYS Division of the Budget, Johnson Associates, Inc., and the Options Group. Bonus pool estimates and individual payouts vary, and help account for the range in estimated revenues. Revenue outcomes also depend on where graduated tax brackets are placed, which partially accounts for the wide range of preliminary estimates.

### *The critical role of deferred bonuses in a Bonus Recapture Tax*

The tax on deferred bonus compensation—including cash, stock, and options granted in lieu of year-end income is a critical companion to the tax on year-end bonuses to ensure that firms do not evade the tax by holding year-end payouts until after the measure’s sunset, and because bonuses are increasingly paid in deferred forms.

Deferred compensation data is not readily available, but historically bonus payouts have been split evenly between cash and deferred compensation awards—such as time-vested stock and options.<sup>29</sup> Compensation experts now expect a trend toward awarding a higher percentage of bonuses as deferred compensation, in response to public outcry over Wall Street compensation levels. Revenue from deferred bonuses will therefore be likely to at least equal revenues from year-end cash bonuses.

## **II. Close loopholes and reform New York’s tax system to make it fairer and more effective**

New York’s state and local tax system places an increasing cost burden on property taxpayers (both owners and renters). At the same time, state tax credits to businesses, and financial firms in particular, siphon away hundreds of millions of dollars yearly. The result is a steep imbalance that holds back the economic progress of working families, increases the need for costly income supports and services, and provides very little marginal return on state tax dollars handed back to large businesses.

We should permanently close a number of **financial industry tax loopholes to generate ongoing annual revenues of more than \$300 million**. The special deductions and tax exemptions available to entities like banks and hedge funds are the result of an antiquated tax structure. Updating the law will make New York’s tax law treat financial firms more like other businesses.

The state should also seriously consider placing a **temporary cap on corporate tax credits and other tax breaks**, whose overall impact on revenues or growth to the state have not been well examined, but have grown in recent years to a cost of \$4.5 billion. In some specific cases, such as the Empire Zones program, they clearly cost the state far more than they produce.

In addition, **New York State should reform its permanent personal income tax structure** in a way that increases the progressivity of that tax while providing the revenue necessary to reduce the pressure placed on the local property and sales tax bases, and meet New York’s pressing budget needs on a recurring and sustainable basis.

### *Reform of financial industry tax rules*

**Close the loophole on hedge funds and private equity firms.** New York City taxes the business income of unincorporated businesses (at a four percent rate) but the state does not—largely because unincorporated businesses used to be mainly small businesses. Hedge funds and private equity firms now profit enormously from this unintended loophole. Establishing a state tax on unincorporated businesses with annual business income over \$3 million will ensure that high-earning hedge funds are fair contributors. New York City’s LLCs and LLPs (which is how hedge funds are typically organized) had a combined taxable income of \$20 billion in 2005 and paid almost 75 percent of the

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<sup>29</sup> Alexis Leondis, “Bonus Pay Changes Put ‘Massive Wrench’ in Wall Street Divorces,” Bloomberg News Service, March 24, 2010, <http://www.bloomberg.com/apps/news?pid=20601109&sid=aB3HPM8qfcVc>.

city's Unincorporated Business Tax revenue, which amounted to \$800 million and equaled 40 percent of the city's tax on corporations. **Projected new revenue depends on tax rate.**

**Tax hedge fund management fees of non-residents.** In his fiscal 2010 Executive Budget proposal, the governor proposed to "expand the nonresident personal income tax to include income received from hedge fund management fees." The revenue impact was estimated at \$60 million. This was not included in the enacted budget, but as the governor's proposal explained, "Currently, only a small portion of such income is taxed as compensation, with the remainder deemed tax-free capital gains. This proposal will result in equal treatment of this income for residents and nonresidents." **Projected new revenue: \$60 million.**

**Increase filing fees for large LLCs and partnerships.** In 2003, the maximum Limited Liability Company (LLC) filing fee was increased from \$10,000 to \$25,000, and the higher maximum was in effect for tax years 2003-2006. Filing fee collections increased from \$26.5 million in 2002 to an average of about \$72 million for 2003-2006. In 2008, however, the fee basis was replaced with a fixed fee structure and the maximum lowered to \$4,500. The state could restore the \$25,000 maximum filing fee and apply it to both LLCs and general partnerships over some very high business income threshold. An alternative would be to add brackets at the top end of the graduated fee structure. **Projected new revenue: \$50-\$100 million.**

**Adopt Corporate Tax Disclosure.** Revenue neutral, but disclosure and transparency measures are a good addition to any Wall Street reform package. New Yorkers for Fiscal Fairness recommends adopting corporate tax disclosure for publicly traded firms subject to taxation under 9-A and 32 and any successor taxes.

**Limit Banks' Bad Debt Deductions to Bad Debts.** This will bring New York into line with federal rules and with other states that allow banks to deduct only those debts that have actually been written off by the bank as bad debts. Currently, in New York a bank is allowed to take tax deductions based on an estimate of debts that are expected to become worthless in the future—providing a deduction for debts before they actually become "bad" or uncollectible. Closing this loophole will end phantom deductions that leave millions of dollars with banks, instead of in state coffers. **Projected new revenue: \$25 million.**

**Reform Deduction Rules for Banks' Subsidiary Capital.** This reform will ensure that a bank's tax liability appropriately reflects that bank's level of activity and presence in New York by requiring the add-back of expenses related to subsidiary capital under the bank tax, and eliminating the 20 percent reduction in the wage factor portion of the apportionment formula. Under current law, bank taxpayers are allowed to deduct 17 percent of interest income from subsidiary capital, 60 percent of dividend income and net gains from subsidiary capital, and 22.5 percent of income from government obligations from income subject to tax. However, unlike corporate taxpayers that are allowed similar deductions, bank taxpayers are not required to add back to income the expenses related to these deductions. **Projected new revenue: \$35 million.**

**Eliminate the Hedge Fund Loophole under New York City's Unincorporated Business Tax.<sup>30</sup>** New York City taxes the fees received by managing partners in private equity and hedge funds but exempts the profit share received by managing partners ("carried interest")—usually 20 percent of the

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<sup>30</sup> Fiscal Policy Institute, "Re-thinking the New York City Business Tax Treatment of Private Equity Fund and Hedge Fund 'Carried Interest'" April 15, 2008.

profits generated by the pooled investment of the limited partners. This amounts to a large tax loophole on hedge fund partners' profit/income. Other unincorporated businesses get no such exemption. Eliminating the carried interest exemption is needed on tax equity grounds but it will also help the City lessen its reliance on extremely regressive taxes like the sales tax hike adopted by the City last year. While any estimate of the possible yield of such a change is very rough, eliminating the carried interest exemption could generate upwards of \$100 million annually. **Projected new revenue (NYC): \$100-\$200 million.**

### **III. Support federal action needed for more fiscal relief, job creation, and to ensure fair corporate taxation**

New York's government, labor, business and civic leaders should work with their counterparts in other states and at the national level to secure a much needed extension of state fiscal relief.

During recessions, the federal government works to stimulate the economy by increasing spending and cutting taxes. This requires deficit spending, which the federal government can do, and which it should do during recessions. Even those who campaign vigorously for reducing the federal deficit in the long run, argue that job creation must be the short-term priority because severe unemployment pushes up the demand for government services, increasing the deficit.<sup>31</sup>

When the federal government does not help the states sufficiently during recessions, state budget-balancing cuts ultimately cancel out a significant part of the positive impact of federal stimulus efforts. The \$800 billion stimulus package President Obama and Congress adopted in February 2009 included \$135 billion for state fiscal relief. This state fiscal relief played a major role in allowing New York and the other states to balance their 2008-2009 and 2009-2010 budgets with fewer service cuts and fewer tax increases than would have been required otherwise.

The State Division of the Budget estimates that this aid package provided New York State with \$6.15 billion of gap-closing aid as the state worked to balance its 2008-2009 and 2009-2010 budgets, which helped close 31 percent of New York's budget gap last year.<sup>32</sup> ARRA's fiscal relief will also help close the 2010-2011 state budget gap, but this federal relief will start to run out before the end of the 2010-2011 state fiscal year.<sup>33</sup>

State fiscal relief took two main forms in ARRA: (1) a temporary increase (until December 31, 2010) in the federal government's share of Medicaid costs (referred to as the Federal Medicaid Assistance Percentage or FMAP), and (2) a State Fiscal Stabilization Fund comprised primarily of federal aid designed to forestall a significant portion of education budget cuts that were otherwise likely to occur throughout the nation.

<sup>31</sup> Lawrence Mishel and David M. Walker, "Address Jobs Now and Deficits Later," *Politico*, February 24, 2010.

<sup>32</sup> Phil Oliff, Jon Shure, and Nicholas Johnson, "Federal Fiscal Relief for States is Working as Intended," Center on Budget and Policy Priorities, June 29, 2009.

<sup>33</sup> Elizabeth McNichol and Nicholas Johnson, "Recession Continues to Batter State Budgets; State Responses Could Slow Recovery," Center on Budget and Policy Priorities, February 25, 2010. New York is far from alone; almost all states are likely to face enormous budget challenges through at least 2012. Total state budget shortfalls for 2010 and 2011 are likely to reach \$375 billion.

Given the continuing nature of state governments' fiscal problems, it is essential that New York's leaders work with the President and Congressional leadership to extend ARRA's state fiscal relief components so that the phase-out of this aid will dovetail more closely with the real recovery of state-level economies and finances.

New York State needs 750,000 jobs created by 2014 to make up for those lost during the recession and to accommodate continued growth in the labor force.<sup>34</sup> Given this compelling job creation need, and the long-term damage that prolonged high unemployment would create, a robust federal job creation program is needed to boost short- and long-term economic growth with targeted wage subsidies, public service jobs, and infrastructure investments.

Additional federal fiscal relief to the states is critical to prevent state economies from spiraling further downward as a result of damaging state and local budget cuts. Federal assistance also needs to be targeted to direct job creation to bring down unemployment and put the national economy on a path toward sustained recovery. New York's leaders should make this an urgent priority.

New York's leaders should also work for the repeal of the federal law (P.L. 86-272) that prohibits the states from taxing the income of corporations that have sales in a state but no property or employees. This outdated 1959 law—originally intended to be temporary—has the effect of exempting a growing percentage of the income of multi-state and multi-national firms from taxation by any state.

This is particularly urgent as more states, including New York, move to apportioning corporate income for state taxation purposes solely on the basis of the portion of a firm's sales in the state. Until P.L. 86-272 is repealed or substantially reformed, New York State should adopt a “throwback rule” to stop the loss of corporate income revenues due to the interaction of Single Sales Factor apportionment and this outdated federal law.

#### **IV. Give Main Street the help it needs**

The temporary financial industry windfall measures and permanent loophole reforms will create significant New York State revenue in three timeframes:

**2010 and 2011 revenues:** approximately \$6 billion per year for two years from the payroll tax on bonus cash, or some combination of the temporary options outlined above on pages 16 and 17 for recapturing some of Wall Street's profit windfall.

**2011-2015 revenues:** at least \$4 to \$5 billion from the tax on deferred bonus compensation from 2010 and 2011 if the temporary bonus tax is adopted.

**Ongoing annual revenue:** \$300 million or more, beginning in 2010, from closing tax loopholes.

These revenues should be used to help close the state's recession-driven budget gaps and to fund the phase-in of a property tax “circuit breaker.” In addition, to restore the state's budget to structural balance

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<sup>34</sup> Fiscal Policy Institute, “New York State's Economic and Fiscal Outlook for 2010-2011,” Feb. 3, 2010. The Economic Policy Institute estimates that to allow for labor force growth and to restore the 5.0 percent unemployment rate that existed in December 2007, the first month of the current recession, the United States would need 11 million jobs. Heidi Shierholz, “Positive job growth but not enough to reduce unemployment rate,” Economic Policy Institute, April 2, 2010.

while meeting the state's important service commitments and to fund a circuit breaker solution on an ongoing basis, permanent tax reform and cost savings measures will be needed. Making the personal income tax structure more progressive on a permanent basis—by increasing the rates on the state's highest income households substantially above the current permanent rate of 6.85 percent—can help New York generate the revenue to meet these objectives without undermining working families' economic progress. In addition, state policy makers should also give serious consideration to the other budget balancing recommendations which have been identified by the Better Choice Budget Campaign.<sup>35</sup>

***Providing effective property tax relief by restoring the cuts in aid to local governments and school districts and by phasing in an expanded Property Tax Circuit Breaker***

Restoring the Governor's proposed cuts in state aid to local governments and school districts will reduce the pressure on property taxes across the board. But there will still be many households with property tax bills that represent an inordinate share of their income. The answer is to couple state aid restorations with the phase in of a well-targeted, middle-income property tax "circuit breaker" that can provide meaningful tax relief on a cost-effective basis to those homeowners and renters who are most overburdened.

For many New York families, property taxes have risen more dramatically than their incomes. The result is that many middle-income families and senior citizens are under real pressure to sell their homes and move away. Renters also get hit by rising property taxes as increases are rolled into higher rents. To keep our communities strong, stable, and thriving, we need to fix our state-local tax system so that taxes reflect a household's income. One reform that is essential to achieving this goal is to provide a refundable credit through the income tax to households whose property taxes represent an excessive percentage of their income.

New York State has repeatedly cut income tax rates on the wealthiest taxpayers since the late 1970s, losing an estimated \$8 billion annually.<sup>36</sup> In response, local property taxes have been raised to compensate for the reductions in state aid to local governments and school districts, since these local governments and school districts remain responsible for the delivery of many basic services. Righting the balance by using a portion of the taxes on Wall Street's windfall profits to fund the initial phase-in of a property tax "circuit breaker" is critical for stabilizing New York State's economy, especially now.

New York State has a circuit breaker that needs to be revamped to deliver effective property tax relief to more middle- and lower-income households. A circuit breaker uses income tax rebates to ensure that a household's annual property tax bill does not exceed a certain percentage of annual household income. This approach effectively targets those households that are most at risk and most in need of economically stabilizing measures.

A circuit breaker also ensures that localities do not lose out on the revenue they sorely need to provide essential services, while at the same time avoiding the misuse of precious state funds on rebates to households that do not need the help—an overdue fix for current property tax relief policy.

A proposal to extend circuit breaker rebates to households whose property tax bills take an unmanageable share of their income should be phased in over four years, allowing the state time to regain its fiscal

<sup>35</sup> For more detail regarding these recommendations, see page 14 of this report and [www.abetterchoiceforny.org](http://www.abetterchoiceforny.org).

<sup>36</sup> Fiscal Policy Institute, "The Path Not Taken: How New York State Increased the Tax Burden on the Middle Class and Cut Taxes for its Highest Income Taxpayers by Over \$8 Billion a Year," available at <http://www.fiscalpolicy.org/taxhistory2.htm>.

footing, while ensuring that the most overburdened households get relief quickly. In the first year, an expanded middle-class circuit breaker should rebate a meaningful portion of property taxes to at least 16 percent of New York households (including renters), targeting that aid to those households whose property tax bills threaten to force them out of their homes most immediately. By the fourth year of phase-in, a meaningful middle-class circuit breaker should reach the 30 to 35 percent of New York's households who are most overburdened by property taxes relative to their incomes.

To make a circuit breaker solution sustainable over time while meeting the state's important service commitments and restoring the state's budget to structural balance, permanent tax reform measures will be needed. Making the personal income tax structure more progressive on a permanent basis—by increasing the rates on top-tier payers above the current 6.85 percent rate—will help generate the revenue needed without undermining working families' economic progress.

### ***Helping to Close New York State's budget gap for fairness and recovery***

Right now, the state faces a \$9 billion deficit. Revenues collected from the windfall tax package proposed here should be used to reduce budget cuts, with a portion of those new revenues used to fund a phased-in, well-targeted circuit breaker. Restoring the budget will prevent the loss of jobs in government agencies, schools, health care facilities and other budget-funded programs—and will also stem the indirect loss of jobs in supplier firms and the induced loss of jobs in retail services, construction, transportation and other industries where jobs are affected by the loss of workers' purchasing power.

In the longer term, permanent reforms and ongoing revenue generators can help equalize local tax burdens and pay for economy-building investments. These should include reducing budget cuts to economy-boosting programs that retain and create jobs, and renewing New York's aging infrastructure.

**Restore state aid to localities to reduce local tax burdens.** Repeated reductions in the state's contribution to local expenses drive up property taxes. Mayor Bloomberg says the governor's proposed \$1.3 billion cut in local aid to New York City could mean cutting 19,000 city employees, including 8,500 teachers, 3,100 police officers and over 1,000 fire fighters. Restoring state aid to localities is an important first step to stem local economic decline and return prosperity to communities across the state.

**Fund essential services and programs in the state budget.** The governor has proposed slashing program budgets—including cutting school aid by five percent, or \$1.1 billion; cutting health care funding by \$1 billion and slowing spending growth on Medicaid even as costs and enrollment increase; and reducing spending on state agencies by \$1 billion. Even seemingly small budget items make a huge difference: Governor Paterson's proposed 2010-2011 budget eliminates all state funding (\$35 million) for the Summer Youth Employment Program, a critical on-ramp to adult employment for low-income youth. Last summer, SYEP provided more than 50,000 jobs in New York City alone.

**Invest in public transportation, to create jobs and put New York workers back to work while maintaining infrastructure vital to a prosperous New York.** MTA service cuts and fare hikes make travel to work increasingly difficult, particularly as working families are pushed to the geographic margins of New York City. Increased automobile traffic, exacerbated by transit cuts, is expensive for workers and slows buses. Investment in public transportation creates jobs on the front end and enhances the productivity of all businesses in the communities it serves. To minimize harmful service cuts and regressive 2010 fare hikes, a portion of federal transit capital aid should be made available to the MTA operating budget.

## Conclusion

It is critical to take steps now to halt the decimation of New York's human, economic and physical infrastructure.

Public investments like education, human services, transportation, and municipal infrastructure help make our state, towns and cities great. Excessive tax-cutting over the past two decades and the ill effects of the Great Recession mean that state revenues are inadequate to maintain strong, stable communities and a world-class economy. This has left New York's families—the state's most critical economic resource—in deep and long-term trouble.

New York has a choice for its future: We can drastically reduce the public investments that build a prosperous New York. Or we can restore tax fairness and raise additional and much-needed revenues. On a temporary basis, some of Wall Street's record windfall profits should be used to make up for revenues destroyed by the recession. And on a continuing basis, closing loopholes and restoring progressive income taxation will allow New York to budget sustainably for job-generating investments like reliable transit, quality public education and property tax relief.

We also can—and should—levy temporary windfall taxes on Wall Street's taxpayer-subsidized record profits to recapture some of what Wall Street owes New York. Both windfall taxes and extended federal aid to states are critical components of righting the balance of New York's budget this year and next.

These actions are also critical to ensuring that Main Street does not continue to bear the unfair brunt of Wall Street's irresponsible excesses. New York simply cannot afford massive cuts to school aid, health care, and the essential local services and job opportunities (from libraries and police officers to fire departments and teachers) that state funding provides.

The revenue from the temporary taxes on windfall profits—like the bonus payroll tax—will establish urgently needed “circuit breaker” property tax relief and will help close budget gaps for essential services, retaining jobs in the process. We must balance critical public investments with long-term revenue generators that equitably distribute burdens and benefits. We need thriving schools, jobs and communities in order to have thriving middle-class families again.

## Five important facts about the bonus recapture tax

### **#1: New York's financial firms won't move out of state.**

The one-time bonus recapture tax will be collected as a payroll tax from the firms and banks paying out the big bonuses. Large New York City firms and banks won't want to leave Manhattan or the infrastructure they rely on here—and pay all the costs of moving their firms—just to avoid a one or two year tax. As a payroll tax, the tax is collected from the firm regardless of where an employee lives.

### **#2: The UK taxes big bonuses, and London's financial industry is thriving.**

The UK passed a one-time bonus payroll tax last December, aimed at London's financial center. Financial firms made a lot of noise, but none of them has left London. The Conservative Party candidate for prime minister recently proposed a permanent bank tax to fund a permanent tax break for married couples. The *Financial Times* quoted a Conservative official, "Nobody has claimed that [the already enacted bonus tax] has undermined the City's competitiveness."<sup>37</sup>

Early reports suggest that bonuses have not been reduced in proportion to the UK bonus tax. The UK tax was initially expected to raise £550m, but estimates are now over £3 billion. The revenue outcome looks very strong, but as for the British government's stated goal of reducing the practice of high-flying bonus payments, it does not seem to have worked.

The UK's tax on bonus compensation is much steeper than what's proposed for New York: The UK tax reaches all bonuses over £25,000 (\$40,000) with a flat 50 percent. Early reports are that most UK firms continued to pay bonuses heavily in cash even after the imposition of the tax—which should not be too surprising, since the tax also reaches bonuses given as stock and other forms of deferred awards.

### **#3: A Bonus Recapture Tax will amount to less than 10 percent of Wall Street's 2009 profits.**

A one-time tax on big bonuses will not jeopardize Wall Street firms, but it will provide critical revenue for what's really in jeopardy—New York's working families. The added \$4.7—6.9 billion revenue from taxing super-bonuses will mean urgently needed property tax relief for New York's working families and urgently needed revenues to help close New York's deficit and get the state back on track to fiscal stability.

### **#4: New York State's “millionaires” tax is working.**

Last year's millionaire's tax will generate an average \$4.16 billion per year in state revenues—that's a major lift for the state in reducing the budget deficit.

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<sup>37</sup> George Parker, "Banks face £1bn levy if Tories win election," *Financial Times*, April 10/April 11, 2010, p. 4.

Despite Governor Paterson's statements that this temporary personal income tax increase on the top 3 percent of New York incomes is not generating the revenues it is supposed to, the numbers released from his own Division of Budget show otherwise.

The Governor's Executive Budget released on Jan 19, 2010, presented this revised revenue forecast:

<b>Year</b>	<b>Revenue</b>
2009-2010	\$3.643 million
2010-2011	\$5.488 million
2011-2012	\$3.335 million
<b>3-year total</b>	<b>\$12.466 million</b>

On April 28, 2009, the DOB forecast that the just-passed “millionaires” tax should raise:

<b>Year</b>	<b>Revenue</b>
2009-2010	\$4.088 million
2010-2011	\$4.978 million
2011-2012	\$3.870 million
<b>3-year total</b>	<b>\$12.936 million</b>

In either case, \$12.5 billion is a great deal of revenue—and worth a lot to New York State as we face the continued deep recession and substantial budget deficits.

### **#5: The Bonus Recapture Tax plan applies to deferred bonuses, which will generate additional revenues.**

The bonus recapture tax covers all bonus payouts—year-end cash and deferred compensation.

There is talk that banks may give a larger percentage as deferred compensation this year in response to public outcry about outsized recession bonuses. Historically, Wall Street’s bonus payouts have been evenly split between year-end cash and deferred awards. Either way, the bonus recapture tax applies to all bonuses.

## Appendix

### New York's State & Local Taxes in 2007 With Temporary Personal Income Surtax for 2009 - 2011

**Shares of family income for non-elderly taxpayers**

Income Group	Lowest	Second	Middle	Fourth	Top 20%		
	20%	20%	20%	20%	Next 15%	Next 4%	TOP 1%
<b>Income Range</b>	<b>Less than</b>	<b>\$16,000 –</b>	<b>\$33,000 –</b>	<b>\$56,000 –</b>	<b>\$95,000 –</b>	<b>\$209,000 –</b>	<b>\$633,000</b>
	<b>\$16,000</b>	<b>\$33,000</b>	<b>\$56,000</b>	<b>\$95,000</b>	<b>\$209,000</b>	<b>\$633,000</b>	<b>or more</b>
<b>Average Income in Group</b>	<b>\$9,600</b>	<b>\$24,400</b>	<b>\$43,800</b>	<b>\$73,100</b>	<b>\$133,000</b>	<b>\$338,100</b>	<b>\$3,065,800</b>
<b>Sales &amp; Excise Taxes</b>	<b>7.3%</b>	<b>6.0%</b>	<b>4.7%</b>	<b>3.7%</b>	<b>2.8%</b>	<b>1.7%</b>	<b>0.9%</b>
General Sales—Individuals	3.6%	3.3%	2.8%	2.3%	1.8%	1.1%	0.6%
Other Sales & Excise—Ind.	1.5%	0.9%	0.6%	0.4%	0.3%	0.1%	0.0%
Sales & Excise on Business	2.2%	1.8%	1.4%	1.0%	0.7%	0.4%	0.2%
<b>Property Taxes</b>	<b>5.8%</b>	<b>3.8%</b>	<b>3.9%</b>	<b>3.8%</b>	<b>4.1%</b>	<b>3.3%</b>	<b>1.5%</b>
Property Taxes on Families	5.3%	3.3%	3.4%	3.4%	3.6%	2.6%	0.6%
Other Property Taxes	0.5%	0.5%	0.5%	0.5%	0.5%	0.8%	0.9%
<b>Income Taxes</b>	<b>-3.5%</b>	<b>0.3%</b>	<b>3.4%</b>	<b>4.7%</b>	<b>5.8%</b>	<b>7.2%</b>	<b>8.6%</b>
Personal Income Tax	-3.5%	0.3%	3.4%	4.6%	5.7%	7.0%	8.3%
Corporate Income Tax	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%	0.4%
<b>TOTAL TAXES</b>	<b>9.6%</b>	<b>10.1%</b>	<b>12.0%</b>	<b>12.2%</b>	<b>12.7%</b>	<b>12.2%</b>	<b>11.0%</b>
<b>Federal Deduction Offset</b>	-0.0%	-0.1%	-0.5%	-1.1%	-1.9%	-1.1%	-2.7%
<b>TOTAL AFTER OFFSET</b>	<b>9.6%</b>	<b>10.0%</b>	<b>11.6%</b>	<b>11.0%</b>	<b>10.7%</b>	<b>11.1%</b>	<b>8.4%</b>

Table shows 2007 tax law updated to reflect changes in law enacted through October 2009.  
Source: Institute on Taxation & Economic Policy (ITEP), *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*.