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The Impact of New York State's Personal Income Tax on Low Income Working Families

The new edition of the Center on Budget and Policy Priorities' annual report, *State Income Tax Burdens on Low-Income Families*, shows that New York had among the lowest income tax burdens in the country for low-income working families. Most of the relief for these families comes from the State Earned Income Tax Credit (EITC) enacted in 1994. The income tax rate cuts and other changes enacted in 1995 now cost over $5 billion per year but provide very little help to these families.

New York State also provides significant help through the income tax system to working families with children in child care, and it will be increasing the State EITC substantially over the next three years. On the other hand, the new NYS College Tuition Credit which takes effect in 2001 for the first time needs to be reconfigured to be fair to low and middle income working families.

Among the major findings of the Center on Budget and Policy Priorities' analysis of state income tax systems are the following:

! Of the 42 states with income taxes, only Vermont and Minnesota do a better job than New York in shielding both poverty-line incomes and minimum wage-earnings from income taxation.

! New York is one of only four states in which near-poor two-parent families of four — those with incomes at 125 percent of the poverty line — receive a refundable tax credit rather than having an income tax liability (31 states) or no liability (7 states).

! For near-poor single-parent families of three, only Vermont, Colorado and Minnesota provide higher refundable tax credits than New York. Six states provide smaller credits while these families have no income tax liability in seven states and a positive income tax liability in 25 other states.

! Since 1991, New York has increased its two-parent four-person family income tax threshold — the income level at which such a family has state income tax liability — by $9,800. Only Pennsylvania, New Jersey, Delaware, Illinois, California, Minnesota and Colorado have increased their income tax thresholds by greater amounts.

! Only eight states (Minnesota, Pennsylvania, Vermont, Rhode Island, Colorado, Connecticut, California and Maryland) had higher 2000 income tax thresholds for two-parent families of four than New York's $23,800.

- Only six states (California, Minnesota, Vermont, Rhode Island, Colorado and Maryland) had higher 2000 income tax thresholds for single-parent families of three than New York's $22,600.

- New York is one of seven states that has already enacted legislation which will increase its income tax thresholds in the future and one of the four states, together with Massachusetts, Minnesota and New Jersey which will use an expanded state EITC to accomplish this threshold increase. New York's EITC is scheduled to increase from this year's 22.5 percent of the federal EITC to 25 percent of the federal EITC in 2001, 27.5 percent of the federal EITC in 2002 and 30 percent of the federal EITC in 2003 and subsequent years.

Most tax relief for low-income families comes from the state EITC.

Virtually all of this tax relief for low-income working families is attributable to New York's Earned Income Tax Credit (EITC). Enacted in 1994, during Governor Cuomo's last year in office, the state EITC is a powerful tool for supplementing the income of working families and offsetting the regressive burden of state and local sales, excise and property taxes.

In 1994, New York set its state EITC at 7.5 percent of the federal EITC for 1994, 10 percent of the federal EITC for 1995, 15 percent for 1996 and 20 percent thereafter. The multi-year tax cut enacted in 1995 under Governor Pataki accelerated the EITC's implementation, increasing the state EITC to 20 percent of the federal EITC one year early, in 1996. The 1995 tax cut, however, contributed very little in terms of reducing the tax burden on low-income working families on a continuing basis, despite its current $5.2 billion per-year price tag.

- Since 1994 the income level at which a two-parent family of four incurs positive tax liability has risen $9,800 from $14,000 to $23,800. The 1994 tax cuts increased the threshold by $8,260 while the 1995 cuts increased the threshold by only $740. The 2000 expansion of the state EITC to 22.5 percent of the federal EITC increased the threshold by another $800. **Over 84 percent of the $9,800 increase was due to the EITC enacted in 1994.**

- Since 1994, the income threshold for a one-parent family of three has nearly doubled, rising from $11,500 to $22,600. Of the $11,100 increase in the thresholds, $9,000 was attributable to the 1994 tax cuts. The 1995 tax cuts increased the threshold by only $1,300. The 2000 EITC expansion was responsible for the additional $800 increase in the threshold. **Over 80 percent of the $11,100 increase was due to the 1994 EITC.**

Income taxes on poor New York families have decreased substantially since 1994. For families with incomes near the federal poverty thresholds, the 1994 tax cut accounts for more than 80 percent of these declines. The 1995 tax cuts — despite costing $5.2 billion per year — account for less than 6 percent of these savings. The 1999 expansion of the state EITC from 20 percent of the federal EITC to 22.5 percent of the federal EITC which took effect in 2000 was responsible for the remaining decline.

- A two-parent four-person family with income at the 2000 poverty level would have paid $139 if the pre-1994 law were still in effect, but receives a $537 refund under current law — a $676 reduction in taxes. The EITC enacted in 1994 gave this family a $571 tax break. The 1995 Pataki tax cuts reduced the tax burden (increased the refund) by $35 while the most recent expansion of the state EITC to 22.5 percent of the federal EITC reduced the tax burden (increased the refund) by $70.

- A one-parent three-person family with income at the poverty line receives a $776 refund under current law but would pay $99 in state income taxes if the pre-1994 law were still in effect. Of this total $875 tax reduction, the 1994 EITC is responsible for $733 while the Pataki 1995 cuts reduced this family's taxes (increased their refund) by $50. The expansion of the state EITC to 22.5 percent of the federal EITC reduced the taxes (increased the refund) by $92.

The New York State EITC is currently scheduled to increase from 22.5 percent to 30 percent of the federal EITC over the next three years, providing additional relief to low-income working families.

State income tax burdens for New York's low-income working families will decrease even more over the next few years. Under legislation enacted in 1999, the NYS EITC will increase to 25 percent of the federal EITC for 2001. Under legislation enacted in 2000, the NYS EITC will increase to 27.5 percent of the federal EITC in 2002 and to 30 percent of the federal EITC in 2003.

The continuation of these expansions of the state EITC, however, are tied in law to the continuation of the state's ability to use federal Temporary Assistance to Needy Families (TANF) block grant funds or state matching (Maintenance of Effort or MOE) funds to pay for the state EITC. Specifically, both the 1999 law increasing the state EITC from 20 percent to 25 percent of the federal EITC and the 2000 law increasing the state EITC to 30 percent of the federal EITC in 2003 provide that this rate will revert back to the 20 percent level beginning with any tax year in which any federal action (as certified by the Commissioner of the Officer of Temporary and Disability Assistance):

- materially reduces or eliminates New York state's TANF block grant allocation, or

- materially reduces the ability of the state to spend federal TANF block grant funds for the EITC or to apply state general fund spending on the EITC toward the state's TANF maintenance of effort (MOE) requirement.

New York is now using TANF block grant funds to pay for a substantial portion of the state EITC.[1] The Governor's most recent Executive Budget, for example, estimates that New York will use TANF funds to cover $323 million of the approximately $500 million that the state EITC is expected to cost during the 2001-2002 state fiscal year.

While there are arguments for and against using TANF funds for this purpose, there is no justification for making the continuation of this particular tax reduction contingent on federal welfare policies while having no similar "fiscal prudence" trigger for the billions of dollars of other tax cuts that have been enacted in recent years.

If the economy continues to slow down or enters into a recession, welfare caseloads can be expected to increase from their current low levels. Since the TANF block grant is a fixed amount, the need to finance cash public assistance and other TANF programs may call into question the ability to finance the expansion of the earned income tax credit with TANF funds, thereby pitting two somewhat overlapping groups of needy families against each other.

In addition, this provision has significant technical shortcomings,[2] and it will create a great deal of uncertainty for a very vulnerable population over the next year and a half as the U. S. Congress considers the reauthorization of the 1996 federal welfare reform law that established the TANF block grant mechanism. This law is currently scheduled to expire on September 30, 2002.

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[1] The final TANF regulations adopted by the U. S. Department of Health and Human Services last April gave the states the ability to use TANF block grant funds to pay not only for EITC expansions but for the entirety of the portions of state EITCs (whether pre-existing and/or new) that are actually refunded to TANF eligible families. TANF block grant funds can not be used to cover either the portions of state EITCs used by TANF eligible families to reduce their tax liabilities to zero or any portions of state EITCs going to taxpayers who are not TANF eligible. To take maximum advantage of this opportunity, last year New York State amended its state TANF plan to define all families with children that meet New York's financial criteria for the EITC as being TANF eligible, although they would not be able to receive traditional cash assistance unless they met other more restrictive criteria.

[2] For example, this provision makes the continuation of a part of the state's tax law subject to a determination by a state administrative official that a federal administrative, statutory or regulatory change has "materially" reduced the state's ability to use funds for a particular purpose without giving any guidance as to what would and what would not be material in such a context.

In recognition of the importance of the EITC in providing tax relief to a very hard-working but frequently-ignored population, this so-called “reversion” provision should be repealed. If state legislators believe that the state’s overall tax reduction program is too large to be sustained without this use of federal funds, it should reduce or eliminate other less meritorious tax cuts that are scheduled to take effect over the next several years.

Low-income New York families who qualify for the dependent and child care credit get additional help through the NYS income tax system.

Over the past four years, New York has increased the value of its dependent and child care credit for the lowest income families from 20 percent to 110 percent of the comparable federal credit while increasing the income limit for the highest percentage credits from $10,000 to $25,000. In addition, New York made the credit *refundable* in 1996 and subsequent years. This means that even if a family cannot benefit from the federal credit (which is not refundable), it will receive the full New York credit.

Families with annual incomes below $25,000 are eligible for a refundable state credit equal to 110% of their federal dependent and child care credit. For these families, the federal credit is equal to 30 percent of child care expenditures, up to a maximum of $2,400 for a single child and $4,800 for two or more children. Therefore, a New York family with two or more children and income below $10,000 would be eligible for a refundable credit of as much as $1,584 — depending on their actual expenses. A family with two children with $24,999 income and child care expenses of $4,800 would receive a $1,162 credit (110% of 22%). Families with incomes greater than $25,000 receive a smaller percentage of the federal credit (which is itself phased down from 30% of expenses to 20% of expenses as income increases), ranging from 100 percent for families with incomes between $25,000 and $40,000 to 20 percent for families with incomes above $65,000.

The new NYS College Tuition Credit which takes effect this year needs to be reconfigured to be fair to low and middle income working families.

Another recent change in the state income tax system, a College Tuition Credit, needs fine-tuning if it is to treat low and middle income working families fairly. On the state income tax returns that New Yorkers file in early 2002, for the 2001 calendar year, they will be able to receive assistance, for the first time, with their undergraduate college tuition expenses. This assistance will come in the form of either a tax credit or a tax deduction for a portion of their allowable undergraduate tuition expenditures up to $10,000 per year. The portion of allowable tuition expenditures being subject to the new credit or deduction will increase in four equal steps from 25 percent of those expenses in 2001 to 100 percent in 2004 and thereafter.

Providing taxpayers with the option of taking a credit rather than a deduction is intended to assist lower income taxpayers who do not itemize their deductions. Making that credit refundable is a recognition of the fact that many low income working families have little or no personal income tax liability. In addition, the credit for taxpayers with tuition expenses of less than $5,000 will be calculated as if their tuition expenses were $5,000.

Unfortunately, however, the value of the credit is set at 4 percent of the taxpayer's "allowable college tuition expenses" while the value of a deduction to a high income taxpayer is 6.85 percent (New York's top income tax rate) of his or her comparable expenses. As Table 6 indicates, this means that if a high-income and low-income family have the same net (after TAP, scholarships, etc.) tuition expense, the high-income family will receive a greater benefit, at all except the lowest net tuition levels. The actual net tuition levels at which lower income families receive a greater benefit than higher income families is $2,920. At all tuition levels above this, a high-income family will receive more help than a low income family even if that low-income family has the same or even higher tuition expenses.

When this new tax break is fully phased in, the maximum state assistance for a high-income family with $10,000 or more in tuition expenses will be $685, which is $285 or over 70% more than, a low-income family would receive. Moreover, because this deduction passes through to the calculation of New York City residents' city income tax liability, without the option of a city-level tax credit, this difference for city residents can be even greater. A high-income New York City family could receive tuition assistance through the state and city tax systems of up to $1,050 while a low-income New York City family's total assistance would still be only $400.

Some defenders of the current law have argued that children from low-income families are likely to receive greater scholarship assistance than children from high-income families. This ignores the fact that the calculation of these new tax benefits is based on the net tuition expenses that a family must pay **after** scholarships and other tuition assistance is taken into consideration.

The magnitude of the inequities that can exist under this new tuition tax "break" are evidenced by the examples presented in Table 7. A family with income of $20,000 and net tuition expenses of $5,000 gets less help, in both absolute and percentage terms, than a family with income of $200,000 and tuition expenses of $3,400. In this comparison, one family is paying 25% of its income in tuition while the other is spending only 1.7% of their income for this purpose. Yet, the family with the greater tuition burden, both absolutely and relative to their income, receives less help than the family with a much higher income and a smaller tuition burden.

Middle-income taxpayers in the tax brackets between the top and the bottom (4.5%, 5.25%, 5.9%) will also benefit less from this new tax break than taxpayers in the top 6.85% bracket, since the value of a deduction to any given taxpayer is determined by their top marginal tax rate. Thus, for a family in the top bracket, the maximum benefit of this program when fully phased-in will be $685 (i.e., 6.85% times $10,000) while the maximum benefit for families in the other brackets will be $450, $525 and $590.

To make this new tax break fair to low and middle income working families, it should be reconfigured. At worst, this would mean providing all taxpayers with the same percentage tax break, whether that be 4% or 6.85% or something in between. At best, the value of this break would be based on a calculation of the relationship of a family's net undergraduate tuition expenses to its income.

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Table 1

New York State's Income Tax Thresholds *

	1993 Law Without the Cuomo (1994) or Pataki (1995) Tax Cuts	**1994 Law** With the Cuomo (1994) but Without the Pataki (1995) Tax Cuts	**1999 Law** With both the Cuomo (1994) and Pataki (1995) Tax Cuts	**2000 Law** With both the Cuomo (1994) and Pataki (1995) Tax Cuts and the EITC Expansion to 22.5% of the Federal EITC
Two-parent family of four	$14,000	$22,260	$23,000	$23,800
Single-parent family of three	$11,500	$20,500	$21,800	$22,600

Table 2

Impact of the EITC Expansion on New York State's Income Tax Thresholds

	2000 Income Tax Threshold	2000 Tax Income Threshold with the Expansion of the NYS EITC to 30% of Federal EITC **
Two-parent family of four	$23,800	$24,900
Single-parent family of three	$22,600	$23,900

* A threshold is the lowest income level at which a family has state income tax liability. The threshold calculations include earned income tax credits, or other general tax credits, exemptions and standard deductions. Credits that are intended to offset the effects of taxes other than the income tax or that are not available to all low-income families are not taken into account.

** The New York State EITC will increase from 22.5 percent of the federal EITC to 25 percent in 2001, to 27.5% in 2002 and to 30% in 2003.

Table 3
New York State Income Tax Liability*

	1993 Law Without the Cuomo (1994) or Pataki (1995) Tax Cuts	**1994 Law** With the Cuomo (1994) but Without the Pataki (1995) Tax Cuts	**1999 Law** With both the Cuomo (1994) and Pataki (1995) Tax Cuts	**2000 Law** With both the Cuomo (1994) and Pataki (1995) Tax Cuts and the EITC Expansion to 22.5% of the Federal Credit
Two-parent family of four				
With minimum-wage earnings ($10,712)	$0	($778)	($778)	($875)
With poverty-level earnings ($17,601)	$139	($432)	($467)	($537)
With near-poverty-level earnings ($22,002)	$340	($45)	($105)	($153)
Single-parent family of three				
With minimum-wage earnings ($10,712	$0	($778)	($778)	($875)
With poverty-level earnings ($13,737)	$99	($634)	($684)	($776)
With near-poverty-level earnings ($17,171)	$244	($345)	($402)	($475)

* Negative liability is a refund to the taxpayer.

Table 4

Reduction in New York State Income Tax Liability

	Total Tax Cut Since 1994	Cuomo (1994) Tax Cut		Pataki (1995) Tax Cut		EITC Expansion to 22.5% of the Federal Credit (2000)	
		Amount of Tax Cut	Percentage of Total Tax Cut Since 1994	Amount of Tax Cut	Percentage of Total Tax Cut Since 1994	Amount of Tax Cut	Percentage of Total Tax Cut Since 1994
Two-parent family of four							
With minimum-wage earnings ($10,712)	$875	$778	88.91%	$0	na	$97	11.09%
With poverty-level earnings ($17,601)	$676	$571	84.47%	$35	5.18%	$70	10.36%
With near-poverty-level earnings ($22,002)	$493	$385	78.09%	$60	12.17%	$48	9.74%
Single-parent family of three							
With minimum-wage earnings ($10,712	$875	$778	88.91%	$0	na	$97	11.09%
With poverty-level earnings ($13,737)	$875	$733	83.77%	$50	5.71%	$92	10.51%
With near-poverty-level earnings ($17,171)	$719	$589	81.92%	$57	7.93%	$73	10.15%

Table 5

Impact of the EITC Expansion on New York State Refundable Income Tax Credits

	2000 Tax Refund	2000 Tax Refund with the Expansion of the NYS EITC to 30% of Federal EITC**
Two-parent family of four		
With minimum-wage earnings ($10,712)	$875	$1,167
With poverty-level earnings ($17,601)	$537	$752
With near-poverty-level earnings ($22,001)	$153	$298
Single-parent family of three		
With minimum-wage earnings ($10,712	$875	$1,167
With poverty-level earnings ($13,737)	$776	$1,051
With near-poverty-level earnings ($17,171)	$475	$696

Table 6

Benefit of NYS's "College Tuition Credit/Deduction" to high and low income families at various tuition levels.

(by year, during phase-in period)

(for Calendar Year 2001 Tuition Expenses)

After TAP, etc.	Low-Income Family	High-Income Family
$2,000	$50	$34.25
$4,000	$50	$68.50
$6,000	$60	$102.75
$8,000	$80	$137.00
$10,000 or more	$100	$171.25

(for Calendar Year 2002 Tuition Expenses)

After TAP, etc.	Low-Income Family	High-Income Family
$2,000	$100	$68.50
$4,000	$100	$137.00
$6,000	$120	$205.50
$8,000	$160	$274.00
$10,000 or more	$200	$342.50

(for Calendar Year 2003 Tuition Expenses)

After TAP, etc.	Low-Income Family	High-Income Family
$2,000	$150	$102.75
$4,000	$150	$205.50
$6,000	$180	$308.25
$8,000	$240	$411.00
$10,000 or more	$300	$513.75

(for Tuition Expenses in 2004 and after)

After TAP, etc.	Low-Income Family	High-Income Family
$2,000	$200	$137
$4,000	$200	$274
$6,000	$240	$411
$8,000	$320	$548
$10,000 or more	$400	$685

NOTE: These calculations assume that (1) the low-income family takes the refundable 4% credit, and (2) the high-income family takes the itemized deduction and is in the state's highest (6.85%) tax bracket. In addition to the amounts shown, New York City resident taxpayers who take this itemized deduction will see it pass through to the calculation of their city income taxes. For NYC taxpayers who take this deduction and are in the city's top bracket (3.648%), there will be an additional benefit equal to about 53% of the state benefits shown above (e.g., when fully phased-in, a taxpayer receiving the maximum $685 in assistance from the state government will also receive $364.80 in assistance from the city for a total of $1,049.90 in aid.). There is no credit option available on the city income tax. Beneficiaries of this credit or deduction who itemize on their federal returns will see their federal income taxes increase by a portion of the amount by which their state (and city) income taxes are reduced.

Table 7

Impact on Two Families of NYS's "College Tuition Credit/Deduction," When Fully Implemented

	Family #1	Family #2
Family Income	$20,000	$200,000
Tuition after TAP, etc.	$5,000	$3,400
Tuition as a percent of income	25%	1.7%
NYS Tuition Tax Break	$200	$233
NYS Tuition Tax Break as a percent of tuition expenses	4%	6.85%
(For NYC Resident Taxpayers Only) NYC & NYS Tuition Tax Break	$200	$357
(For NYC Resident Taxpayers Only) NYC & NYS Tuition Tax Break as a percent of tuition expenses	4%	10.5%