FPI
Fiscal Policy Institute

540 Broadway
Albany, NY 12207

press@fiscalpolicy.org
fiscalpolicy.org

July 23, 2025
Nathan Gusdorf, *Executive Director*

Filling the Gaps: State Tax Policy after the One Big Beautiful Bill Act

The new federal budget will cost New York State almost $10 billion annually. The State will have to step in.

Introduction

On Thursday, July 3rd, the U.S. House of Representatives passed the Senate's federal budget reconciliation bill. Informally known as the "One Big Beautiful Bill Act" (OBBBA) and signed into law by President Trump on July 4th, the bill makes permanent major tax cuts enacted in 2017, adding $3.4 trillion to the U.S. federal deficit over the next ten years. The effects will include 17 million Americans losing their health insurance.[1]

The total cost to the New York State budget will be approximately $10 billion annually, concentrated in reductions to funding for Medicaid and related health programs as well as food stamps (SNAP).[2] Some of these funding cuts will mechanically shift program costs to the state budget; others will directly reduce funding for public programs in healthcare, education, and housing, among others. FPI estimates that federal funding reductions to the healthcare system will total $13 billion *in addition to* the $10 billion in cuts that directly affect the State's budget. The most consequential of these effects will be the loss of health insurance for 1.5 million New Yorkers, the closures of hospitals across New York, and the loss of over 200,000 jobs state-wide.

This paper illustrates how the new federal budget legislation shifts the balance of responsibility for fiscal and social policy to state governments. While revenue measures are described towards the end, the argument of this paper is not primarily in support of a specific set of policy recommendations; rather, it shows the following more general conclusions: (i) the current crisis is the result of fiscally unsustainable federal tax cuts enacted in 2017 by President Trump and Congressional Republicans, the costs of which have forced unprecedented cuts to critically important federal social programs; (ii) the New York State economy has the capacity to generate enough new revenue to fill these funding gaps by simply restoring the total level of state taxation to where it stood in 2009; and (iii) filling these gaps will require a break with the recent state policy convention of only allowing tax increases on the ultra-rich, and will instead require broad-based taxation targeted at the top 5 percent of New Yorkers – households earning over $250,000.

[1] "By the Numbers: Senate Republican Reconciliation Bill Takes Health Coverage Away from Millions of People," Center on Budget and Policy Priorities, June 30, 2025: https://www.cbpp.org/research/health/by-the-numbers-senate-republican-reconciliation-bill-takes-health-coverage-away
[2] https://fiscalpolicy.org/wp-content/uploads/2025/07/2025.07.10-Factsheet-on-final-bill-1.pdf

The core of the argument that the state economy has the capacity to fill the gaps is simple: The total value (gross state product) of New York State's economy in 2024 was $2.3 trillion, and total state revenue was $148 billion – reflecting a 6.5 percent tax burden on all state economic activity. Raising this overall tax burden by just 0.45 percentage points on all economic activity would allow the State to generate the $10 billion in new revenue.

First, however, because these tax increases ought to be understood as filling in the gaps left by the federal government, it is necessary to make sense of the federal fiscal context that has produced this strange situation.

Part I: The Republican Party's Fiscal Timebomb

In 2017 a Republican-controlled Congress and then-President Donald Trump passed a set of temporary, deficit-financed tax cuts (referred to as the "Tax Cuts and Jobs Act" or TCJA) that were due to expire at the end of 2025. The deficit cost of these tax cuts – which was initially estimated at $1.5 trillion over the ten year period follow their enactment – grew over time, such that when it came time to consider *extending* these tax cuts in 2025, the deficit cost, absent additional spending reductions, had grown to $4 trillion.[3] The OBBBA extends the 2017 tax cuts and enacts new additional tax cuts with $3.4 billion of deficit spending and $1.2 trillion of spending cuts.

The controversy over the OBBBA arose because Republican leadership wanted to make permanent the 2017 tax cuts, most of which were set to expire at the end of 2025. Why were they temporary? In effect, making the 2017 TCJA tax cuts temporary was a requirement of the "budget reconciliation" process used to pass the TCJA. Reconciliation permits the House and Senate to avoid the usual procedural hurdles to passing legislation—namely, the Senate filibuster—and instead send a bill to the President for signing with a simple majority vote after a limited period of debate.[4]

The reconciliation process can only be used for certain purposes: determining spending, revenues, and the debt limit. Anything in the legislation that does not fall into these categories can be excluded from reconciliation bills (formally, through the invocation of the "Byrd rule"). And—most importantly, for our purposes—budget legislation enacted through the reconciliation process cannot increase the federal deficit in any year *beyond* the ten year window used to estimate the effects of budget legislation.

In the OBBBA, unlike the 2017 TCJA, Republican party leadership avoided once again falling into the political trap of enacting temporary tax cuts by circumventing the reconciliation rules that limit long-term increases to the deficit. The Republican leadership of the Senate Budget Committee quite literally avoided meeting with the official responsible for applying the reconciliation rules (the Senate Parliamentarian) and adopted its own rules according to which extending the expiring TCJA tax cuts would have no impact on the deficit.[5]

---

[3] "Estimated Budget Effects Of The Conference Agreement For H.R.1, The Tax Cuts And Jobs Act," Joint Committee on Taxation, December 28, 2017: https://www.jct.gov/publications/2017/jcx-67-17/

[4] For a helpful explainer, see "Introduction to Budget 'Reconciliation'" by Richard Kogan and David Reich, Center on Budget and Policy Priorities, May 6, 2022: https://www.cbpp.org/research/introduction-to-budget-reconciliation

[5] The rationale given by the Senate Budget Committee leadership was that it shouldn't be treated as a *new* cost to extend current tax rates. This is rather like buying a gym membership for only one month and then declaring that it will cost nothing to extend the membership indefinitely because you already have it. https://www.politico.com/live-updates/2025/06/29/congress/republicans-move-forward-with-controversial-megabill-accounting-move-00432212

Consequently, the federal government now has an even deeper imbalance between revenues and spending that will grow over time, which will likely be used to justify future cuts to social spending. State governments must respond by picking up the fiscal slack and recognizing that the current low-tax environment created by successive Republican federal budgets is incompatible with continuing to provide an adequate level of public services to working and middle class people.

How the TCJA changed the federal tax landscape

The 2017 TCJA enacted across-the-board tax cuts, chief among them a historic cut to the federal corporate tax rate, from 35 percent to 21 percent. It also lowered income taxes for all taxpayers, increased the exemption for the estate tax, and created special tax breaks for the owners of pass-through businesses, among other provisions.

The high cost of extending the 2017 tax cuts – which required the OBBBA to include massive spending cuts – is driven by across-the-board tax cuts that benefit middle and upper-middle income earners as well as the rich. As shown in the Table 1, over half of the cost of the total package of tax cuts – $2.2 trillion – is from income tax rate reductions for nearly all taxpayers. The second most expensive tax cut is minimizing the impact of the Alternative Minimum Tax (AMT), a policy measure designed to ensure that higher-income taxpayers pay some minimum amount of tax. The non-partisan Tax Policy Center estimates that these changes reduce the number of taxpayers who would be subject to the AMT from 7.6 million to 200,000.[6]

The across-the-board nature of these tax cuts – which primarily benefit the top 40 percent of households – has not received as much attention as the tax cuts that benefit the very richest households; but they explain why renewing the 2017 package was *so* costly, and why it resulted in deeply unpopular cuts to safety-net programs.

Table 1. Highest Cost Tax Cuts[7]

Tax Cut	Ten Year Cost
Extend rate reductions for all brackets	$2.2 trillion
Extend exemption from the Alternative Minimum Tax	$1.4 trillion
Extend and increase deduction for pass-through businesses	$820 billion
Increase estate and gift tax exemption to $30 million	$210 billion
Lower rates on multinational profit shifting	$135 billion

[6] "How did the TCJA change the AMT?" Tax Policy Center, January 2024: https://taxpolicycenter.org/briefing-book/how-did-tcja-change-amt

[7] "Estimated Revenue Effects Of Tax Provisions To Provide For Reconciliation Of The Fiscal Year 2025 Budget As Passed By The House Of Representatives On May 22, 2025" Joint Committee on Taxation, U.S. Congress, May 28, 2025: https://www.jct.gov/publications/2025/jcx-26-25/. The extension of the increased standard deduction and the elimination of the deduction for personal exemptions are not included here for the sake of simplicity, and because they roughly offset each other (with the increased standard deduction costing $1.3 trillion over ten years and the elimination of person exemptions raising $1.9 billion over ten years). The cost of the increased child tax credit, $800 billion over ten years, is also excluded on the grounds that the program is best treated as a transfer through the tax code rather than a tax cut.

*No tax on overtime**	$90 billion
*No tax on car loan interest**	$30 billion
*No tax on tips**	$30 billion

Note: Certain new tax breaks – for overtime, car loan interest, and tipped income – are due to expire at the end of 2028, limiting their fiscal impact on the ten-year cost estimate. This likely reflects a bet that these tax breaks will be made permanent in the future.

Table 2. Marginal Tax Rate Reductions for Married Taxpayers

Pre-TCJA Tax Rate	New Tax Rate	Income Range
10%	10%	$0-$23,200
15%	12%	$23,201-$94,300
25%	22%	$94,301-$201,050
28%	24%	$201,051-$383,901
33%	32%	$383,901-$487,450
35%	35%	$487,451-$731,200
39.6%	37%	$731,201 and above

Table 2 presents the change in the marginal tax rate for married taxpayers that was initially passed in the 2017 TCJA and extended in the OBBBA. In examining Table 2, it is important to understand that the effect of lowering a marginal tax rate benefits all taxpayers at *or above* the applicable income group. That is, a taxpayer earning $500,000 is in the 35 percent bracket, which did not see a rate cut under the TCJA. But this taxpayer still benefits from the marginal rate reductions in all lower brackets.

In order to offset some of the cost of these tax cuts, and in order to make the corporate tax cut permanent, the 2017 TCJA included some revenue raising measures. The largest revenue raiser was a limitation on the federal income tax deduction for state and local taxes (known as the "SALT cap") to $10,000. The OBBBA extends the SALT cap, while raising it to $40,000 for taxpayers earning up to $500,000.

The SALT cap had a particularly negative effect in New York State, where a resident in the top 1 percent of earners, who previously might have deducted upwards of $100,000 in state and local taxes, now could only deduct $10,000.

States quickly found a "workaround" however, by which high earners who are owners of pass-through businesses (partnerships, LLCs, S corporations) could pay a voluntarily state business tax, take a federal tax deduction for those payments, and receive a state income tax credit for the same amount. The net result is that the SALT cap has a far lower impact for the top 1-2 percent of taxpayers in higher tax states who can take advantage of the workaround because they earn their income through business ownership.

In New York, the SALT workaround is called the "pass-through entity tax" or PTET. Each year, approximately $16 billion in PTET is paid, 90% of which benefits taxpayers earning over $500,000.

The OBBBA raises another $775 billion by terminating clean energy credits enacted under the Inflation Reduction Act and through limitations on the tax credits that subsidize health insurance purchased on the Affordable Care Act exchanges, in particular for lawful immigrants.

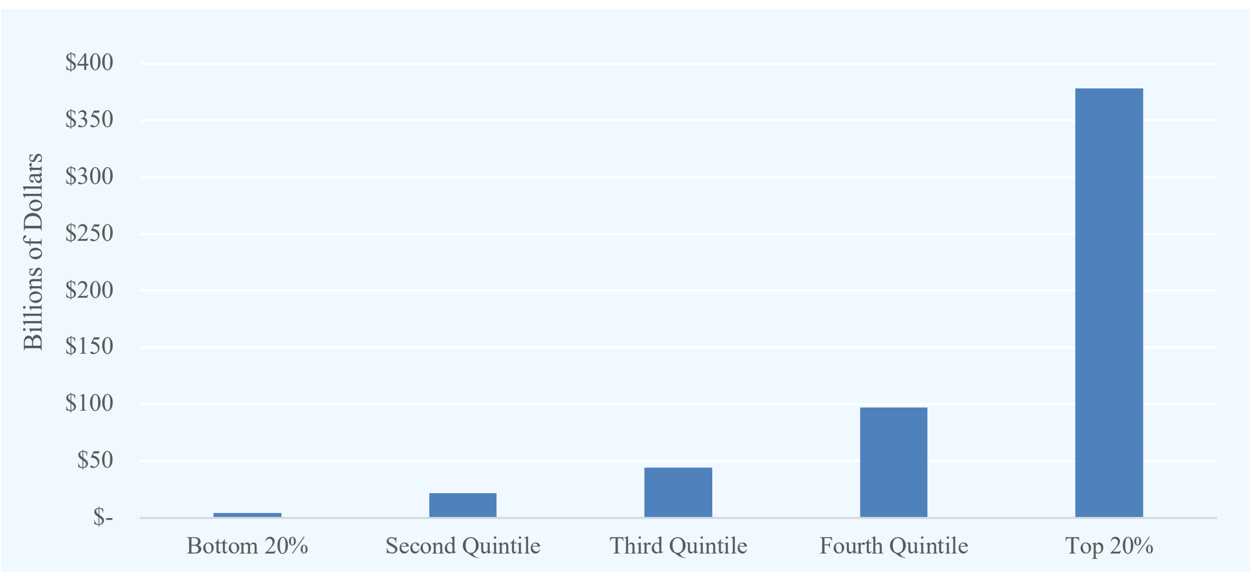
Table 3. Largest Revenue Raisers[8]

Revenue Raiser	Ten Year Estimate
Limitation of the SALT Deduction	$950 billion
Termination or limitation of clean energy credits	$500 billion
Limitations on Premium Tax Credits	$275 billion

Part II: Winners and Losers in the New Budget Legislation

While the OBBBA tax cuts are spread across all taxpayers, they disproportionately benefit the well-off. The Joint Committee on Taxation, a nonpartisan committee of tax lawyers and economists working for the U.S. Congress, estimates that the one-year revenue loss from OBBBA tax cuts will be $545 billion in 2027, of which $378 billion, or 70 percent, is accounted for by tax cuts that benefit the top 20 percent of earners, approximately those households earning over $120,000.

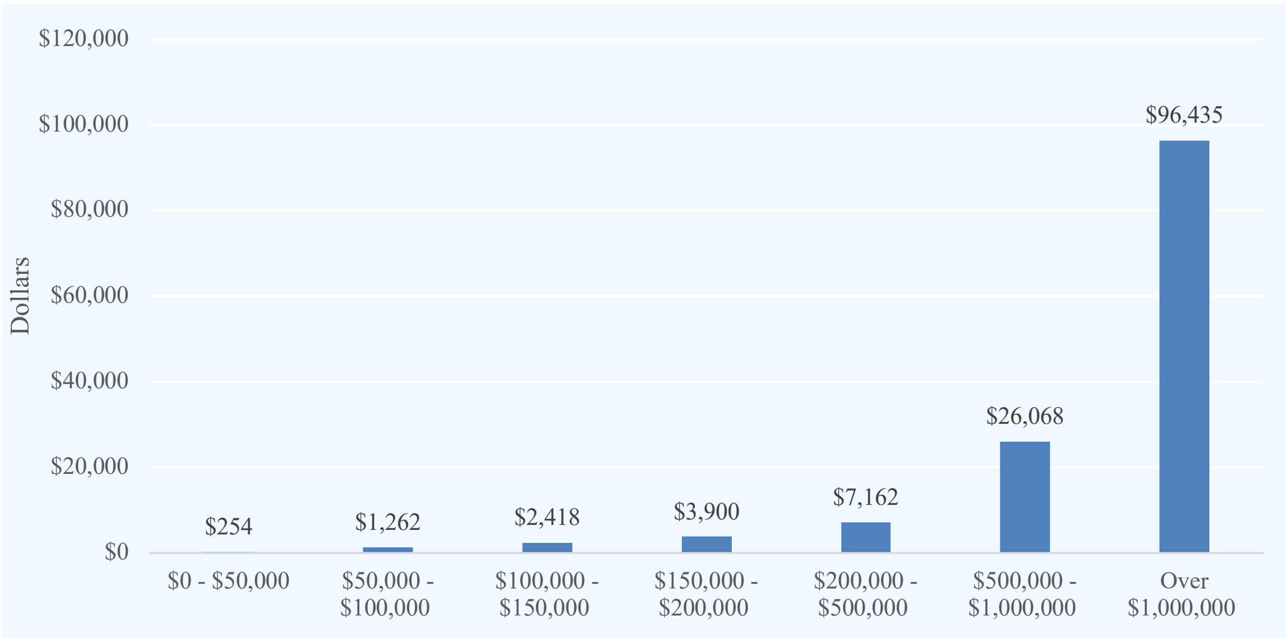
Figure 1. Benefits of OBBBA tax cuts by income quintile, 2027



8 "Estimated Revenue Effects Of Tax Provisions To Provide For Reconciliation Of The Fiscal Year 2025 Budget As Passed By The House Of Representatives On May 22, 2025" Joint Committee on Taxation, U.S. Congress, May 28, 2025: https://www.jct.gov/publications/2025/jcx-26-25/. The extension of the increased standard deduction and the elimination of the deduction for personal exemptions are not included here for the sake of simplicity, and because they roughly offset each other (with the increased standard deduction costing $1.3 trillion over ten years and the elimination of person exemptions raising $1.9 billion over ten years).

The unfair distribution of benefits also stands out when we look at the average benefit for a taxpayer within each income group. Those earning over $1 million per year receive an average annual tax benefit of $96,435, whereas those in the median income range of $80,000-$100,000 receive about a $1,500 annual benefit.

Figure 2. OBBBA tax cut benefits by income, per taxpayer



Importantly, these estimates from the Joint Committee on Taxation reflect the *net* effect of all the provisions of the OBBBA – both tax cuts and revenue raisers. So, while some provisions of the bill will eliminate certain tax benefits, the *net* effect is still to substantially reduce the tax burden on high earners.

Figure 3. Change in effective federal income tax rate under OBBBA for a married couple, by income group

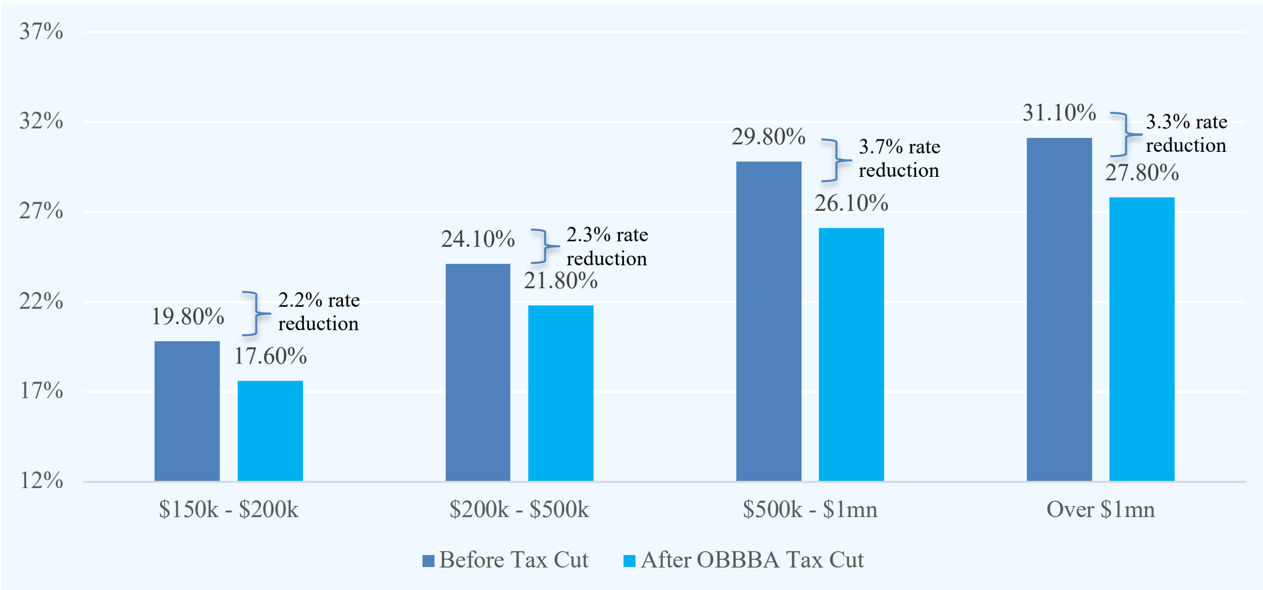


Table 3 above shows the marginal income tax rate reductions for each income bracket. These calculations reflect the overall *effective* tax rate reduction for the income groups above based on *all* of the OBBBA provisions. That is, a married couple earning over $1 million annually would see their top marginal income tax rate drop from 39.6 percent to 37 percent. But they also benefit from numerous other provisions of the OBBBA, such that (for an average taxpayer) they see an overall federal income tax cut of 3.3 percentage points. While the effects of the act potentially vary on a state-to-state basis, we assume that the SALT cap is negligible for top taxpayers, given the availability of the PTET workaround, and that this is therefore a reasonable estimate of their tax benefits under the act.

It has become something of a taboo in New York State politics to even consider raising the tax rate on households making less than $1 million in *annual income*. This ceiling has crept upwards in recent years as the legislature's more recent proposals for taxes on "the rich" were limited to the few thousand taxpayers earning over *$5 million* per year. But the distributive effects of the OBBBA show us that while the millionaire-earner population has benefited disproportionately, it is really all upper-middle income households that have received a substantial tax break. And, therefore, policymakers must consider whether it is appropriate to recapture those breaks through state tax increases.

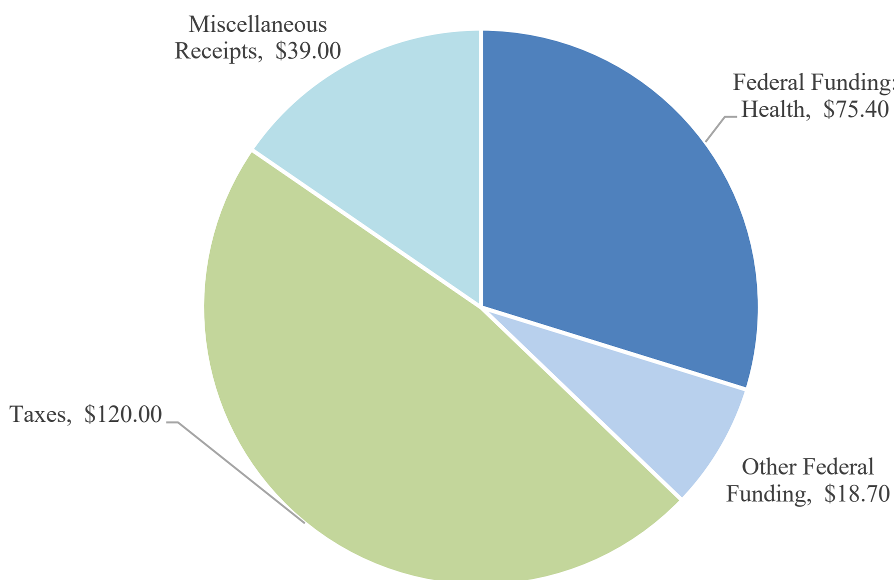
Part III: Can New York State Fill the Gaps?

What does all of this mean for New York? Of the $254 billion State budget for the current fiscal year (fiscal year 2026), $89 billion is expected in federal operating aid, of which $72 billion is funding for Medicaid and related health programs, such as the Essential Plan. FPI's estimate of $10 billion of lost federal funding under the OBBBA reflects the net effects of lost federal funding as well as the increased costs to the State that will come from statutory obligations to cover, for instance, new Medicaid enrollees and a share of the cost of SNAP benefits.

It is important to be clear about the magnitude of OBBBA cuts without slipping into the hysteria that often characterizes budgetary debates. As the state budget was negotiated at the beginning of this year, it became common for our elected leaders to declare that nothing could be done to backfill the funding cuts that were coming down the pipeline. While making up a $10 billion funding loss will be an unusual fiscal challenge, it is economically feasible if approached with the right policy tools.

Moreover, concerns about the viability of new revenue measures must be weighed against the human and economic costs of doing nothing, when 1.5 million New Yorkers are expected to lose their health insurance coverage and 216,000 jobs will be lost due to this new legislation, increasing the unemployment rate by up to 50 percent.

Figure 4. Sources of state revenue before OBBBA (in billions)



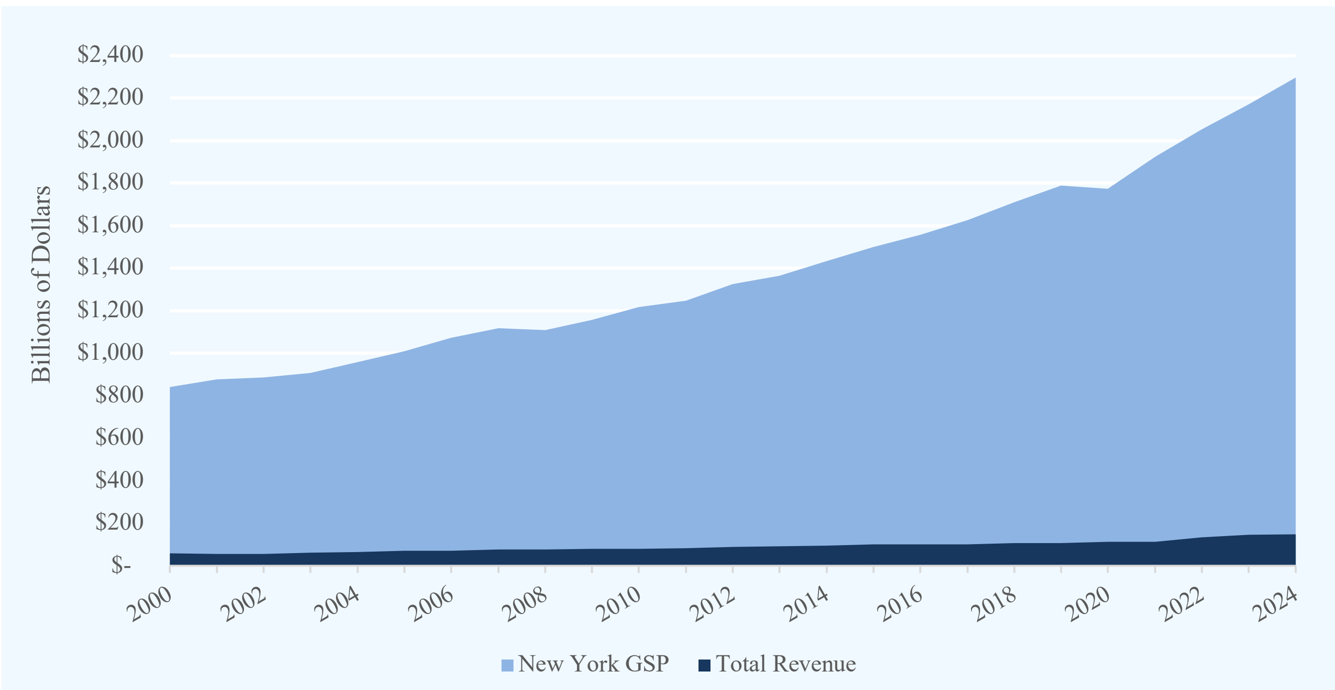
How to measure state spending

We typically think of the federal government as the primary fiscal actor in U.S. social policy, but state and local governments play an equally important role as fiscal agents. The federal government pays for Defense, Medicare, Social Security, approximately half of Medicaid, and a bundle of other smaller programs. But most of the government services that individuals interact with on a regular basis are provided by state or local governments. In New York, state and local governments fund public K-12 education, SUNY and CUNY, a bit less than half of Medicaid, the MTA network (including Metro-North and the LIRR), and ordinary government services such as the police and sanitation. Thinking through the limits and opportunities on the State's ability to finance a higher level of service provision will be necessary in determining how to respond to these federal budget cuts.

The only coherent way to make sense of government spending is by relating it to the economy and tax base that support such spending (contrast this approach with the many op-eds that simply gawk at the sheer number of dollars spent by the government – an effective admission of fiscal illiteracy).

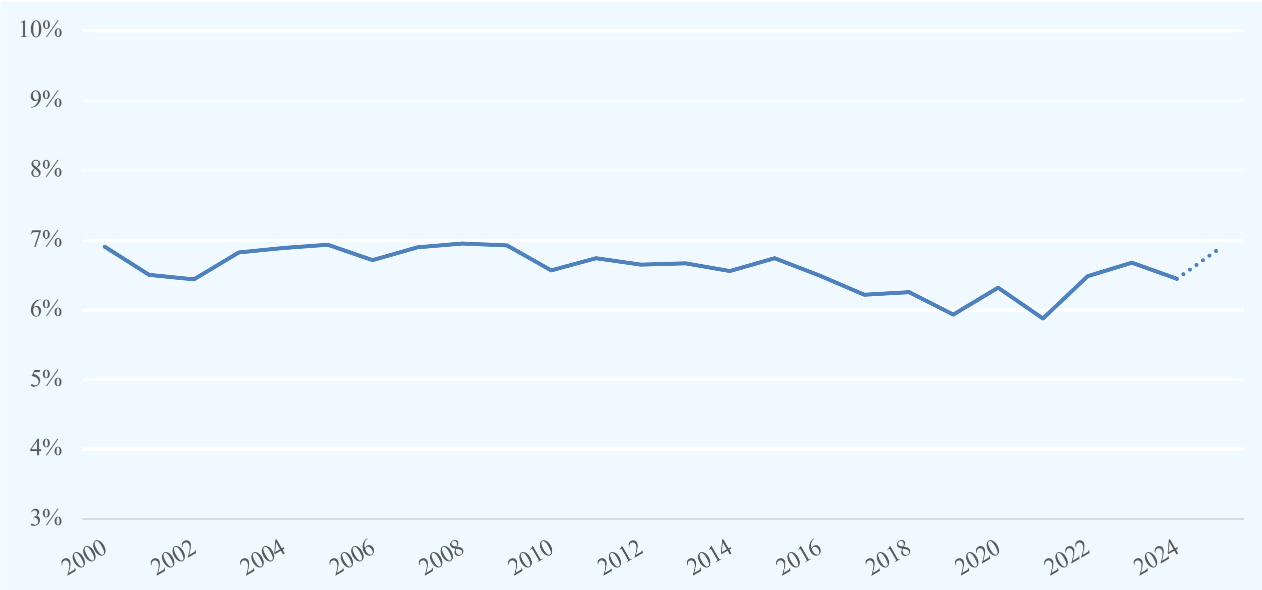
In New York this year, state revenues are expected to be $120 billion in tax receipts and $39 billion of miscellaneous revenues from sources such as gambling fees. These revenues come from a state economy with a total output of $2.3 trillion as of 2024, which is roughly the size of the whole Canadian economy.[9] Setting total state revenue against gross state product, we see that the state's tax take is generally around 6.5 percent of total economic activity in recent years.

Figure 5. New York State Gross State Product and State Revenue, 2000-2024



[9] Gross Domestic Product: All Industry Total in New York. https://fred.stlouisfed.org/series/NYNGSP

Figure 6. New York State Revenue as share of Gross State Product, 2000-2024



Setting aside the question of which tax instrument is best to raise revenue, these figures indicate that the state economy has the capacity to support the additional spending necessary to at least cover federal funding losses. Increasing the tax burden by just 0.45 percentage points on all economic activity statewide would yield $10 billion, enough to fully offset the federal cuts that directly impact the State budget. The dotted line in Figure 6 above shows the increase in overall tax burden necessary to generate an additional $10 billion of annual revenue: non-trivial, but hardly a radical departure.

Of course, taxes do not work on an economy-wide basis; they are specific to a particular tax base such as personal income or consumer sales. But it is useful to begin with a holistic examination of the state economy's ability to support new spending, and then to consider which tax instruments are best suited to generating that revenue.

The principle of broad-based taxation

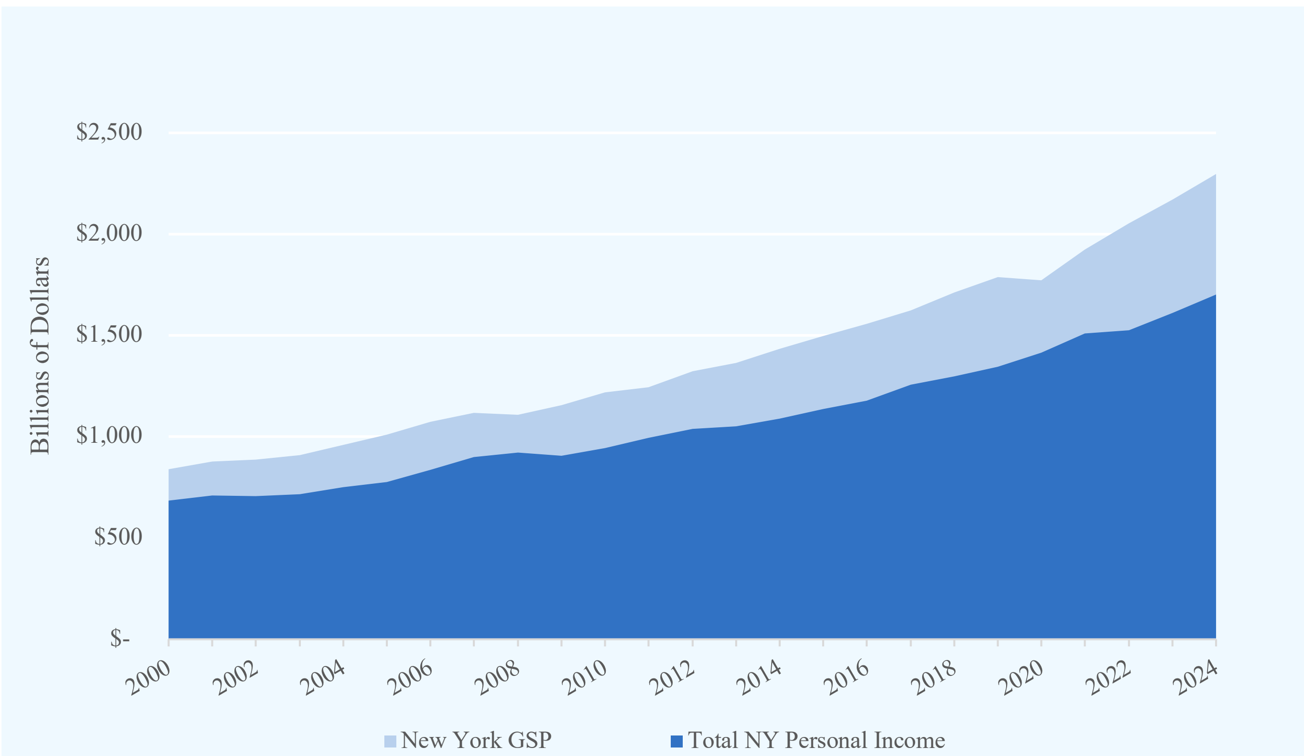
This discussion is related to one of the most important principles of tax policy: the idea of "broad-based" taxation. The income tax, which taxes all income earned by individuals, from whatever source derived, is considered a broad-based tax because it applies to a wide category of economic activity. Many proposals for tax policy reform attempt to "broaden the base," which can mean eliminating special preferences that treat similarly situated taxpayers differently. Suppose, for instance, that two individuals each earn $80,000. But one of these individuals gets a large deduction for their luxury SUV payments (perhaps the SUV lobby successfully included this deduction in the federal budget) whereas the other individual gets no special deductions. Broadening the base of the income tax, in this case, would mean eliminating the special SUV tax benefit so that these two individuals are treated the same way by the tax law.[10]

[10] Somewhat comically, this example was originally written before the final version of the OBBBA was released. The enacted legislation roughly does just this by granting a tax deduction for car loan interest.

Broad-based taxation is important for fairness reasons as well as revenue. There are many different taxes on the books in New York State – the real estate transfer tax, the pari-mutuel tax – but many of these taxes play a negligible role in raising revenue. Nearly all tax revenue comes from three sources: the personal income tax, the sales tax, and the corporate tax.

The personal income tax is the largest revenue raiser, responsible for about $75 billion per year (out of about $115 in total tax revenue). New Yorkers earn *in total* $1.7 trillion per year, meaning that 4.4 percent of all income earned in the state is taxed by the State. This average rate reflects higher tax rates on top earners and relatively low tax rates on lower income groups. The graph below shows total personal income and New York's gross state product since 2000. As the chart shows, taxing personal income comes close to taxing all economic activity, meaning that such a tax can raise substantial revenue at even modest rates.

Figure 7. New York State Gross State Product and Total Personal Income[11]



[11] https://fred.stlouisfed.org/series/NYNQGSP; https://fred.stlouisfed.org/series/NYOTOT

This fundamental fact of public finance is also illustrated by looking at where state revenue actually comes from. The table below shows the eight most significant sources of state revenue in the last fiscal year. The personal income tax is the workhorse, supplemented by the sales tax and the corporate tax. None of the State's numerous other tax instruments are able to raise revenue on such a scale.

Table 4. Sources of state revenue in fiscal year 2025

Tax Instrument	Revenue
Personal Income Tax	$76.4 billion
Sales Tax	$20.4 billion
Corporate Tax and Insurance Tax	$11.7 billion
Estate Tax	$1.3 billion
Real Estate Transfer Tax	$1.26 billion
Licenses and Fees	$904 million
Motor Vehicle Fees	$899 million
Cigarette Tax	$800 million

In confronting the current federal funding crisis, policymakers must first consider the capacity of the state economy to support a higher level of taxation, and then select the appropriate broad-based instrument for raising the required revenue. Policymakers must emphatically *resist* the inclination to look to narrow tax bases that seek to punish unsavory behavior – say, taxing helicopters and luxury handbags – as these will never generate revenue on the needed scale.

Part IV: Managing Funding Gaps and New State Tax Policy

The State's response to this crisis should be guided by a few principles:

- **The human and economic costs are immediate.**

Sudden and drastic cuts to state spending will soon saddle low- and middle-income families with unmanageable healthcare costs, increase unemployment by eliminating over 200,000 jobs in the healthcare sector and related industries, and increase food and housing insecurity by eliminating SNAP benefits for hundreds of thousands of beneficiaries. Once these consequences come about, they will have long-term effects that will be hard to reverse.

- **The fiscal risks to the State are medium-term and long-term, not short-term.**

As discussed in this section, the State has enough cash on hand and adequate fiscal capacity to fill funding immediate gaps. Over a multi-year time horizon it may be necessary to make hard choices about rebalancing the budget and revenues, but the State should *first* protect against the human costs of spending cuts, and *then* assess how to handle long-term fiscal challenges.

Mechanically, some of the best options for fiscal management include the following:

Draw down reserves to temporarily bridge gaps

The State can initially bridge funding gaps by drawing on its $31 billion in reserves. Because the OBBBA spending reductions will be phased in over multiple years, and because the revenue mechanisms discussed below will take time to implement, a short-term *bridge* strategy is needed to protect against the immediate costs of funding cuts.

For many years prior to the Covid-19 pandemic, the State had under $2 billion in reserve and would not have been able to weather a downturn in tax revenues or other fiscal risks. Today, thanks in large part to a period of surpluses driven by Covid relief measures, the State's reserves are not only at their highest level ever, but exceed the level recommended by experts including the New York State Comptroller.[12] A 2019 report by the Comptroller recommends that reserves rise to 10 percent of General Fund revenues, which the State projects at $125 billion for the current fiscal year. That leaves over $18 billion of additional reserve funds that can be used to bridge short-term gaps, while still maintaining a responsible reserve balance.

Increase personal income tax rates

The personal income tax is already the State's most substantial source of revenue, and small changes can yield significantly more. Raising the tax rate on all households earning over $250,000 per year would be a sound starting point for recapturing many of the benefits under the OBBBA. A tax increase of this type would yield approximately $6.5-7 billion in revenue for each percentage point increase.

[12] https://www.osc.ny.gov/files/reports/budget/pdf/rainy-day-reserves-2019.pdf

Because of the prominence of the income tax, and the general tendency of taxpayers to think of a "tax increase" as meaning an income tax increase, it is common for policymakers feel the need to look elsewhere for revenue raisers, intuiting that the income tax is in some sense tapped out. This intuition is mistaken.

Experts in tax policy and public finance generally agree on the principle of broad-based taxation described above, although they often disagree about whether to rely primarily on income or consumption as the best tax base. More progressive experts tend to prefer an income tax base, which taxes on the basis of ability to pay and shifts more of the tax burden to higher earners, while more conservative experts tend to prefer a consumption tax, which is thought to "reward" saving and investment. Whichever way you slice it, there are only a few options when it comes to broad-based taxation, and the income tax is currently the workhorse of both federal and state revenue.

The natural objection to raising income tax rates will be that New York *already* has excessively high income tax rates. Some even argue that New York has the highest tax rates in the country, but this is misleading. As shown below, state income tax rates are roughly middle-of-the-pack by state standards for most taxpayers, and tax rates on top earners fall *below* peer states.

In 2021, the State enacted increases to the personal income tax rates for taxpayers making over $1.08 million (single) or $2.16 million (married). The top tax rate increased from 8.82 percent to 9.65 for the $1.08/$2.16 million bracket, 10.3 percent for those making over $5 million, and 10.9 percent for those making over $25 million. These tax increases have raised approximately $3.5 billion in annual revenue since they were enacted.

Table 5. Prior and current New York State personal income tax rates

Pre-2021 Rates				Current Rates			
Single Filer		Joint Filer		Single Filer		Joint Filer	
Income Range	Tax Rate	Income Range	Tax Rate	Income	Tax Rate	Income	Tax Rate
$215,400 - $1.08M	6.85%	$323,200 - $2.15M	6.85%	$215,400- $1.08M	6.85%	$323,200 - $2.16M	6.85%
Over $1.08M	8.82%	Over $2.16M	8.85%	$1.08M - $5M	9.65%	$2.16M - $5M	9.65%
				$5M - $25M	10.3%	$5M - $25M	10.3%
				$25M	10.9%	$25M	10.9%

The construction of ultra-high income tax brackets means that less than 0.1 percent of all New York taxpayers actually pay the top rate of 10.9 percent, which applies only to those earning over $25 million in annual income. When pundits compare New York's top tax rate with other states, they suggest that a meaningful number of high earners are subject to this tax rate; in fact, it is a few thousand households at most.[13] It is also common for pundits to *add* the New York City income tax to the New York State

[13] FPI estimate based on tax data from the New York State Department of Tax and Finance.

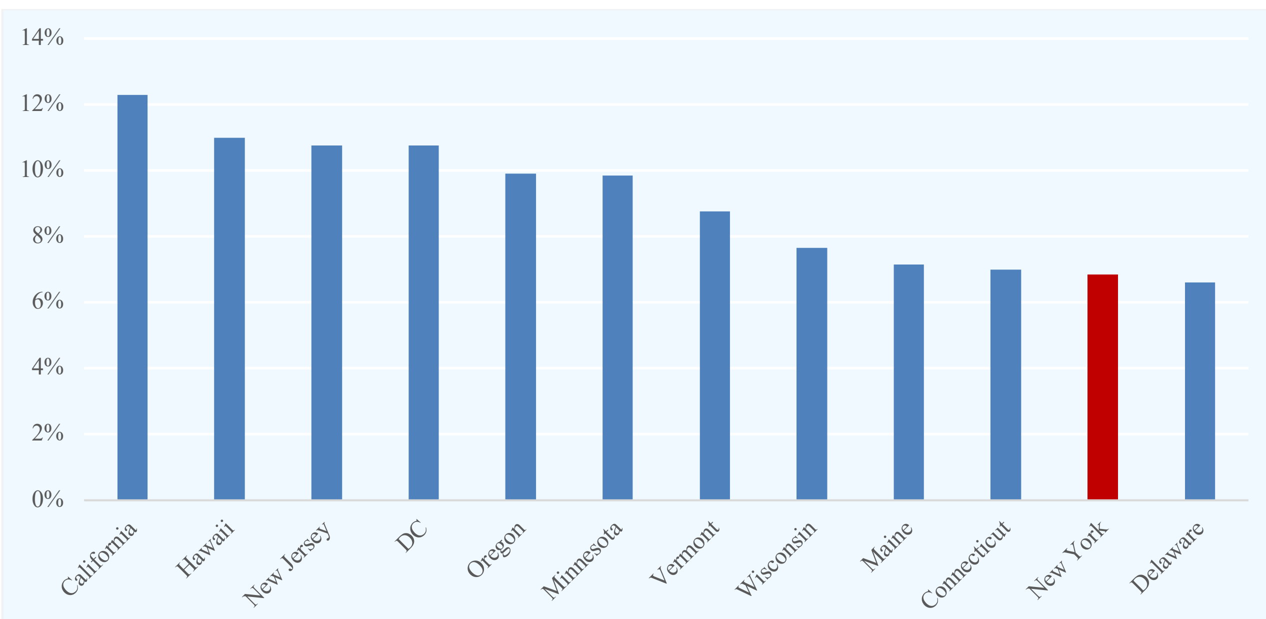
income tax in calculating the top tax rate. This is misleading for two reasons: First, taxpayers who do not live in New York City pay no income tax to New York City, and a large share of the state's top earners do not live in the city. Second, the city is its own taxing jurisdiction, and, like all cities, its very existence depends on a substantial annual budget. The city's existential fiscal requirements should not be used as a lever to hold down statewide tax rates.

Table 6. Top income tax rates in peer states

State	Top Tax Bracket	Top Tax Rate
New York	$ 25M	10.9%
California	$ 1.4M	13.3%
New Jersey	$ 1M	10.75%
Hawaii	$ 200,000	11.0%

Moreover, these tax rates on the top earners hide relatively *low* tax rates on the normal-rich. A married couple earning $1 million annually pays a lower state income tax rate in New York than in ten other states, including Maine and Wisconsin.

Figure 7. State income tax rates on a married couple earning $1 million/year



In recent years the State has also *lowered* the income tax rate on upper-middle class taxpayers. This process of cutting "middle class" taxes – which in practice means cutting the tax rate on the top 20 percent – began in 2018 under then-Governor Cuomo and continued through the last legislative session's budget under Governor Hochul. Married couples earning between $161,500 and $323,200 paid a state income tax rate of 6.65 percent prior to 2018. Tax cuts enacted that year gradually stepped down this income group's tax rate to 6.0 percent, and the most recent budget set them to drop even lower, to 5.8 percent by 2027 – putting their tax rate below what they would pay in Montana or South Carolina. This most recent tax cut will cost $1 billion per year, and the previous round of tax cuts was estimated by the state to cost over $4 billion by 2025 – meaning that the 2021 tax increases on the top earners have primarily funded tax cuts for the upper-middle class, rather than program expansion that would help all New Yorkers.[14]

While quantifying the overall benefits of public services is a tall task for another day, it is intuitively clear that public programs provide relatively more benefit to working- and middle-class households. Public schools ensure that K-12 education is available to all, free of charge. Medicaid and the Essential Plan provide health insurance to up to 9 million New Yorkers in a state of 19.5 million people, meaning that most New Yorkers have family members or close friends who would be uninsured without these programs. The MTA network provides affordable transit in the downstate region and is a necessary condition of the very existence of New York City. These observations are far from controversial, but elected officials are quick to forget their *fiscal policy* implications: that middle income households are better off paying tax and receiving robust public services than receiving tax breaks at the cost of deteriorating public services.

Impose the Sales Tax on Services

One of the most salient differences between U.S. tax system and other national tax systems is the absence of a Value Added Tax (VAT), which is a type of sales tax that broadly applies to goods and services and is harder to avoid than a retail sales tax.[15] New York has both state and local sales taxes, but in general these taxes only apply to purchases of goods, and many goods are exempted from sales tax (for example cable television).

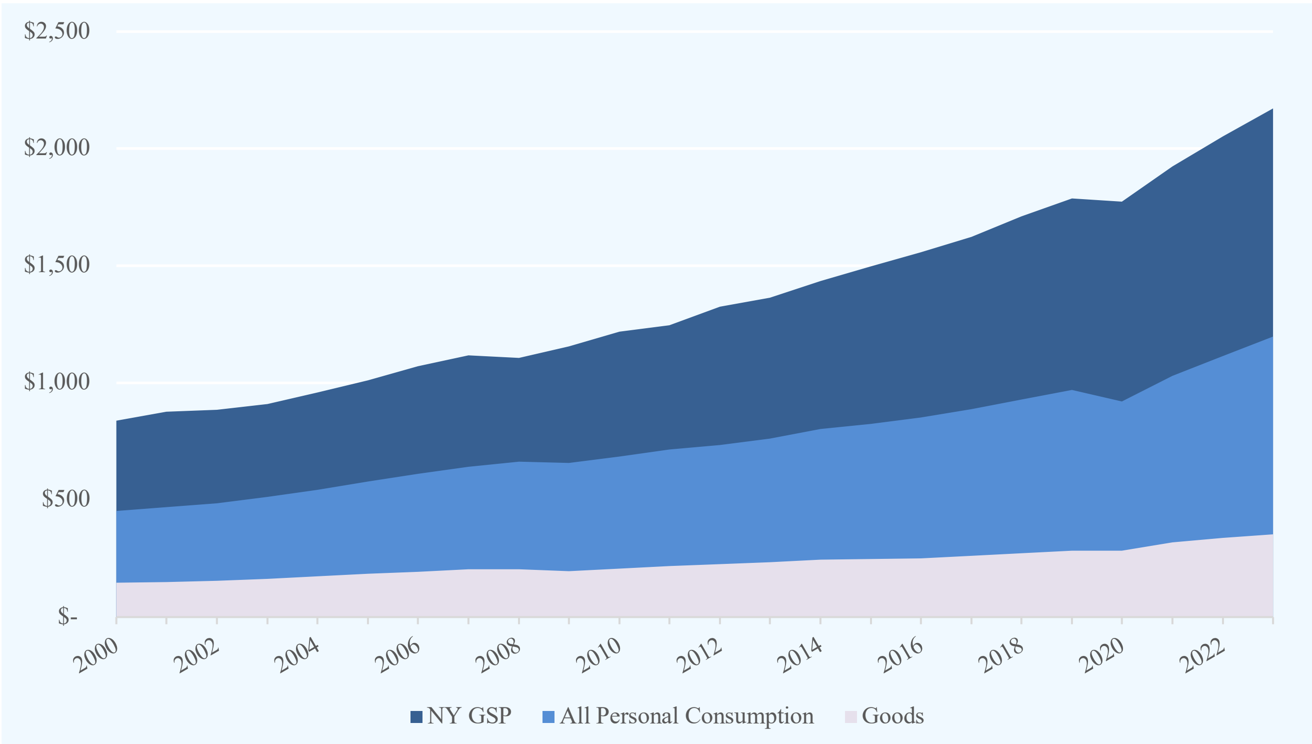
While sales taxes are often unpopular among policy advocates because they tend to be regressive, they can also be effective revenue raisers. The limitation of the sales tax in most of the U.S. to only cover goods seriously limits its revenue potential. The value of all goods consumed in the state is about $350 billion per year, whereas the value of all services consumed is about $850 billion per year (see Figure 8 below). Extending the sales tax to cover services at just a 1 percent rate would raise nearly $9 billion, almost fully offsetting the OBBBA cuts.

The chart below shows New York's gross state product since 2000 alongside total personal consumption and personal consumption of goods. It illustrates the extent to which the State's reliance on a small share of the consumption tax base undermines long-term revenue potential.

[14] https://www.governor.ny.gov/news/governor-cuomo-signs-fy-2022-budget-and-announces-continuation-middle-class-tax-cuts-help-new

[15] Informally, the VAT should be thought of as a sales tax in the sense that it is a consumption tax. A VAT is differentiated from a sales tax because it applies at each step of the value chain *but is rebated to all payers other than the end consumer*. That is, a middle-man in the value chain has to pay VAT but receives a rebate for VAT paid, and only the final consumer pays VAT without receiving a rebate. A traditional sales tax is only imposed on the end consumer, making

Figure 8. New York State Gross State Product, Total Personal Consumption, and Personal Consumption of Goods, 2000-2023[16]



Tax all businesses the same way

Finally, one tax measure which would both broaden the tax base and be progressive, is equalizing tax treatment of businesses. Applying the current corporate tax rate of 7.25 percent to all non-corporate business profits earned by taxpayers with individual incomes in excess of $300,000 would raise about $8 billion in annual revenue.[17]

Business taxes are the State's third most important source of revenue, with the corporate tax and insurance tax yielding nearly $12 billion last year. But 95 percent of businesses are now organized as non-corporate entities such as partnerships and LLCs, which pay no corporate tax (they are called "pass-through" businesses because profits "pass through" to the owners with no corporate tax due).[18]

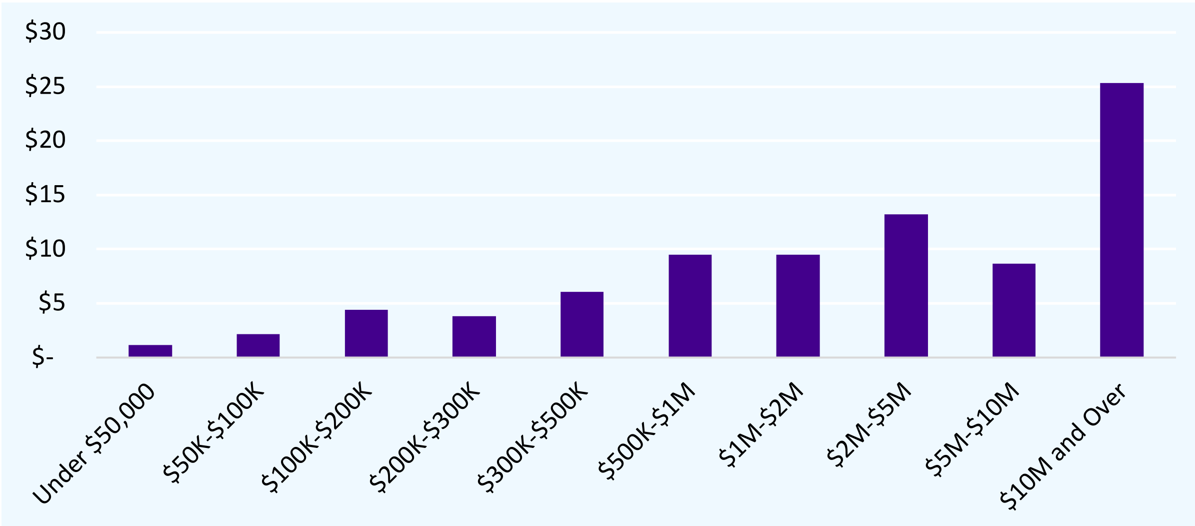
Currently, corporations pay the corporate tax while non-corporate businesses pay no tax on their entity level profits. Non-corporate businesses, or pass-throughs – partnerships, LLCs, and S corporations – are commonly assumed to be small businesses. But big law firms, investment firms, consulting firms, and even Google are organized as pass-through businesses that pay no corporate tax.

Further, only a small share of pass-through business income is earned in New York by middle-income taxpayers. 71 percent of all pass-through income is earned by millionaire taxpayers (who typically earn

[16] https://fred.stlouisfed.org/series/NYNQGSP
[17] Importantly, this threshold describes an *individual taxpayer's income*, not the business's revenue or profit.
[18] This is the statutory structure of the federal tax law, not a "loophole".

their income from business ownership) and 89 percent is earned by taxpayers making over $300,000 per year. Only 5.5 percent of pass-through income is earned by taxpayers making less than $150,000 per year.

Figure 9. Aggregate income from rents, royalties, partnerships, estates, and trusts for New York taxpayers by household income, 2022 (*billions of dollars)*



Conclusion

The federal budget legislation known as the OBBBA has initiated a new era of U.S. fiscal policy in which states will be forced to choose between allowing the human and economic costs of skyrocketing uninsurance rates, job losses, hospital closures, and rising hunger and homelessness, or raising new revenue to stabilize social spending. New York is in the enviable position of having a robust state economy that is capable of generating enough revenue to fully reverse the OBBBA's spending cuts. Policymakers must embrace the principles of broad-based taxation outlined above and accept this new level of state responsibility for maintaining an economy that supports working households.