Testimony on Taxes
Presented to the Joint Fiscal Committees of the NYS Legislature

Submitted by:

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NEW YORKERS FOR FISCAL FAIRNESS

New Yorkers for Fiscal Fairness

My name is Ron Deutsch and I am the Executive Director of New Yorkers for Fiscal Fairness. I would like to thank the distinguished members of the fiscal committees for the opportunity to provide testimony here today.

My testimony will focus on the need to close corporate tax loopholes, the structure and function of the Tax Reform and Fairness Commission and the need to reform our income tax structure over the long term to reduce the pressure on the property tax.

New York State is facing a structural budget gap of $1.3 billion for the coming 2013-2014 fiscal year. This does not take into account the lost revenue and rebuilding expenses associated with Hurricane Sandy or the possibility of New York losing over a billion dollars in Mediacid funding from the federal government.

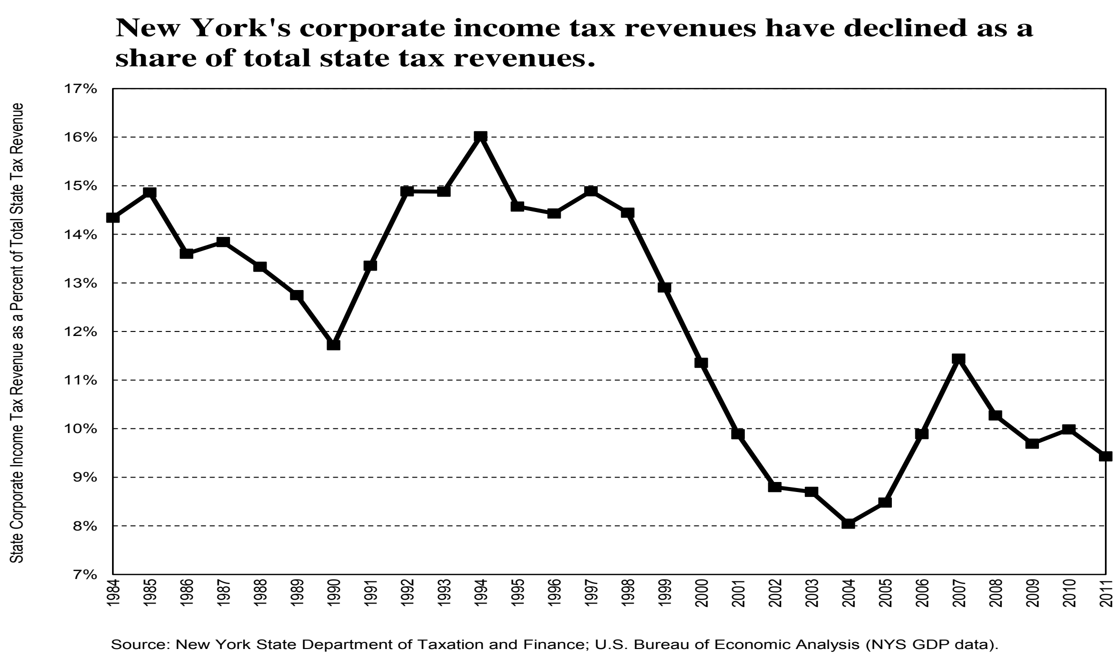
I believe that New York State should raise needed revenue and restore fairness to the tax code by reforming our state corporate tax structure and closing a variety of corporate tax loopholes to make sure small business and big business play by the same rules, and that higher profits are taxed at reasonably higher rates.

Efforts in December of 2011 to make the PIT more progressive and more fair should continue in 2013 by reforming corporate taxes to close loopholes, end costly and ineffective tax subsidies, and fix shortcomings that unnecessarily reduce tax collections and limit resources needed to maintain and invest in the infrastructure, services and educated workforce that foster long-term economic growth.

A simple, targeted corporate tax reform effort would provide over $1 billion in revenue for this year's state budget, and provide a start for the Tax Reform and Fairness Commission to continue reforms.

<u>The Need for Corporate Tax Reform:</u>

I believe that prior to the development of the tax commission we can take steps to immediately close some loopholes, create tax fairness and enforce our current tax laws adequately. The chart below (from the Fiscal Policy Institute) shows how corporate taxes have fallen as a share of the state's total tax revenue.



This precipitous drop in revenue is the result of many different tax cuts enacted over many years. However, the tax cuts enacted under the Pataki Administration are likely the biggest culprit driving this drop in revenue. Governor Pataki characterized the tax cuts implemented during this period as follows in his last Executive Budget.

Since 1995, every major State tax has been cut, making New York the preeminent tax-cutting state in the nation. The breadth and scope of these cuts are remarkable:

- *New York has cut 19 different taxes 81 separate times.*
- *In 1995, total New York State tax collections per $1,000 of personal income were 5.3 percent above the national average. In 2003, State tax collections per $1,000 of personal income were 3.6 percent below the national average.*

By 2006-07, taxpayers will have saved more than $125 billion as a result of Governor Pataki's tax cuts. Cumulative savings will total nearly $167 billion by 2008-09.

The tax cuts enacted under the Pataki admistration, combined with ever increasing tax subsidies to big business (see following chart) has left us with continuous annual budget deficits, underfunded schools and cities on the brink of serious financial distress.

New York State Business Tax Expenditures 2008-2012

(in millions dollars)

Category	2008	Forecast 2012	Percent Change 2008-2012
Corporation Franchise (Article 9A) Tax	$1,134	$1,575	39%
Bank Tax	$150	$136	-9%
Insurance Tax	$851	$887	4%
Corporation (Article 9) Tax	$138	$145	5%
Subtotal, business taxes	*$2,273*	*$2,743*	*21%*
Personal Income Tax	$253	$546	116%
Sales and Use Tax	$957	$1,002	5%
Total, NYS Business Tax Expenditures	**$3,483**	**$4,291**	**23%**

Source: New York State Division of the Budget and Department of Taxation and Finance. Annual Report on New York State Tax Expenditures, 2012-13 State Fiscal Year.

A Corporate Tax Reform Agenda for a Strong Economy

Outlined below are a series of corporate tax reforms that would generate much needed revenue while closing loopholes; leveling the playing field between small and medium-sized New York firms, on the one hand, and large multi-state and multinational corporations, on the other; and, reforming costly and ineffective tax breaks.

1. New York State should refine its laws creating economic development tax breaks to ensure that the benefits of those laws only go to businesses that create and maintain jobs in the state, and not to businesses that offshore jobs or otherwise eliminate them.

In recent decades there has been substantial growth in both the number of tax breaks enacted in the name of job creation and in the cost of those tax breaks. Even though New York State's annual Tax Expenditure Report excludes some very costly tax breaks enacted at the behest of corporate lobbyists, it estimated that the cost of the state's economic development tax breaks increased from $3.48 billion in 2008 to $4.29 billion in 2012.

At the same time, however, very few of the tax breaks enacted in the name of job creation, actually require that the recipients create additional employment opportunities in the state; or that they even maintain their level of employment in the state to benefit from these tax breaks.

Recommendation: To the maximum extent possible, the laws governing each of the state's economic development tax breaks should be amended to require that a business has to, at the very least, maintain its level of employment and compensation in the state to qualify for those breaks.

Recommendation: New York State should reduce the value of the initial Investment Tax Credit (ITC) while increasing the number of additional years (currently set at two) in which ITC beneficiaries can qualify for an Employment Incentive Credit by maintaining or increasing employment in New York. This will reduce (and, in some cases, eliminate) the benefits available to businesses that reduce employment while increasing the benefits to businesses that maintain or increase their levels of employment in New York State over time.

Recommendation: New York State should enact legislation like the proposed "Bring American Jobs Home Act" that eliminates the deductibility of expenses incurred in the off-shoring of American jobs. New York State should also enact legislation that discourages the off-shoring of call centers. In addition, New York State should make businesses that off-shore American jobs ineligible economic development tax breaks.

2. New York State's current limits on the use of business tax breaks should not be eliminated until fiscal balance is restored and the austerity measures on the expenditure side of the budget are eliminated.

In 2010, to help stop the erosion of business tax revenues and to reduce the magnitude of the cuts being made in essential public services, New York State enacted, for the 2010, 2011 and 2012 tax years, a cap of $2 million dollars on the value of the business tax credits that a taxpayer could use in a single year. As the law currently stands, credits in excess of this $2 million annual limit can be claimed by affected taxpayers on returns for tax years 2013, 2014 and 2015.

The caps in place for the 2010, 2011 and 2012 tax years serve to increase state tax revenue above what it otherwise would have been in the fiscal years in which payments for those tax years are made. For example, the 2013-14 Executive Budget indicates that "all funds" business tax receipts for FY 2013 "include $384 million from the tax deferral of certain tax credits, an incremental increase of $71 million" over FY 2012; and that "included in FY 2014 is an incremental increase of $14 million (from $384 million in FY 2013 to $394 million in FY 2014) in receipts from the deferral of certain tax credits."

Recommendation: Just as the 2013-14 Executive Budget proposes to continue the freeze on the implementation of the 2007 settlement of the Campaign for Fiscal Equity lawsuit and to subject the frozen level of Foundation Aid to a "Gap Elimination Adjustment," the 2013-14 enacted budget should extend the $2 million cap on credits; treat credits in excess of the cap in the same way that scheduled Foundation Aid payments in excess of the Foundation Aid caps have been treated; and apply a "Gap Elimination Adjustment" to the credits.

3. New York State should seek federal legislation and enact state legislation to reduce the ability of multi-state and multinational corporations to create "nowhere income."

A 1959 federal law (P.L. 86-272) prohibits a state from taxing any portion of the net income or profits of a multi-state corporation that has sales of goods in a state but no property or payroll in that state. To the extent that (a) the location of a firm's sales is one of the factors used in apportioning that firm's income among the states for tax purposes; and (b) some of that firm's sales are to customers in a state in which it has no property and no payroll, some of that firm's profit is not taxable by any state. This untaxed profit is known as "nowhere income."

As an increasing number of states, including New York, have moved to apportioning income solely on the basis of the portion of a firm's sales in the state (i.e., the Single Sales Factor approached initially adopted by New York in 2005 to be phased in over the course of the next several years), a decreasing portion of the U.S. net income of multi-state and multi-national firms is taxable by any state.

For the last several years, many of the same multi-state and multinational corporations that have lobbied for Single Sales Factor apportionment in the states in which they have substantial property and payroll have been lobbying at the federal level to expand P.L. 86-272 to make even less corporate income subject to taxation by the states. This legislation, which is misleadingly named the Business Activity Tax Simplification Act (BATSA), would allow a firm to have some property or payroll in a state and still escape taxation of any portion of its income by that state.

Recommendation: New York officials should work with officials from other states to advance federal legislation repealing or substantially reforming P.L. 86-272 and to oppose federal legislation that would increase the portions of multi-state and multinational corporations' domestic net income that can be shielded from state corporate income taxation.

Recognizing the problem of "nowhere income," tax experts seeking to establish a uniform and fair system of state-level corporate taxation have long recommended that states adopt either a "throwback" or "throwout" rule (See Institute on Taxation and Economic Policy, "Nowhere Income and the Throwback Rule" at http://www.itepnet.org/tax_topics/corporate_income_taxes.php).

Under a "throwback" rule, sales made in states where a firm's income is not taxable are "thrown back," for apportionment purposes, to the state from which the sales were made. A "throwout" rule is a variation that excludes nowhere sales from entering into the apportionment calculation at all.

Recommendation: New York should adopt a "throwback" or "throwout" rule.

4. New York should restore the integrity of its corporate "Alternate Minimum Tax."

New York State's corporate Alternate Minimum Tax (AMT) was enacted in 1987 to make sure that large profitable firms paid some minimum amount in state taxes.

That 1987 law, which was enacted with the active support of the Business Council of New York State, reduced the state's main corporate income tax rate from 10% to 9% (and to a lower level for small businesses). It also eliminated and/or limited a number of corporate tax preferences. The Investment Tax Credit (ITC), for example, was reduced from 6% to 5% rather than being eliminated but the AMT was established at a 3.5% rate. Credits, like the ITC, could still reduce a firm's tax liability but not below 3.5% of its income.

In addition, the "Double Weighting of Sales," a tax break that had been enacted in 1975 at the behest of the Business Council, was not repealed in the calculation of the main tax at the 9% rate, but the traditional 3-factor formula (that involved the equal weighting of property, payroll and sales and which had applied the main tax before the 1975) change was made applicable to the new AMT.

The intended purpose of this set of changes was to provide that a firm would pay state taxes on its income at 9% with preferences or 3.5% without preferences. such as the ITC. Since 1987, however, the state's main corporate income tax rate has been reduced to 7.1% and the AMT rate has been reduced to 1.75%. But, perhaps even more significantly, tax breaks have been added to the AMT. Single Sales factor apportionment (an even juicier prize for multi-state corporations than the Double Weighting of Sales) now applies to both the main tax and the AMT. And, an increasing number of tax credits are allowed to reduce a firm's taxes below the AMT level.

Recommendation: The Corporate Alternate Minimum Tax (AMT) rate for firms other than manufacturers should be restored to the 3.5% level and the loopholes that have been added to the AMT should be eliminated.

Tax Reform and Fairness Commission/Property Taxes

In a press release that was issued by the three leaders after the December tax law changes were enacted it was announced that they had agreed to the creation of a Tax Reform and Fairness Commission. The release stated that, "The Governor is also establishing a commission to examine a comprehensive overhaul of the state's entire tax code that will make it simpler and fairer for all taxpayers and to create economic growth in the state."

In a later section of that press release, which provides additional detail on the agreed-upon "Fair Tax Code Reform," it is noted that, "Through an executive order, the Governor **has created** the New York State Tax Reform and Fairness Commission to address long term changes to the tax system and create economic growth. The commission will have thirteen members, including four recommended by the Senate and Assembly majority leaders and two recommended by the Senate and Assembly minority leaders. The Chair of the Commission will be appointed by the Governor. All members are required to have expertise in the tax field and will receive no compensation. The Commission will conduct a comprehensive and objective review of the State's taxation policy, including corporate, sales and personal income taxation and **make revenue-neutral policy recommendations** to improve the current tax system. In its review, the Commission will consider ways to eliminate tax loopholes, promote administration efficiency and enhance tax collection and enforcement."

In December of 2012 the Governor announced the appointment of a 10 member Commission and again stressed that it would focus on state income, corporate and sales taxes. Does it sound like something is missing here? It is – the Property Tax.

I strongy recommend that property taxes be included under the pervue of the Commission. We cannot continue to look at taxes in silos. No residents pay just sales and income taxes and no corporations pay just corporate taxes. If we are to fairly examine our tax structure we must look at it in its entirety.

The charts below illustrate the need to include all state and local taxes when trying to determine tax burdens and issues of fairness within our current tax structure.

Furthermore, I would recommend that the Commission not be bound to make "revenue neutral" decisions. If the Commission is to operate properly it should not be bound by politically motivated and predetermined outcomes.

I believe the Commission should:

- be comprised of economists/tax experts and affected parties
- include all state and local taxes
- hold at least 10-15 hearings at geographically diverse regions around the state
- Live streaming of all Commission hearings
- allow for testimony to be submitted electronically and be publically available on the Commission's website
- not have set or preordained outcomes (such as "revenue neutrality")
- consult with additional outside experts as needed
- develop a thoughtful, deliberative plan to make the tax system fair and equitable for all state residents
- have appointments made by Legislature

Property Taxes Get Left Out Of Commission?

Our Consortium of tax reformers and advocates (www.omnibustaxsolution.org) strongy recommend that property taxes be included under the perview of the Tax Reform and Fairness Commission. We believe we cannot continue to look at taxes in silos. No residents pay just sales or income taxes or property taxes. If we are to fairly examine our tax structure we must look at it in its entirety. All of the taxes levied in this state are directly related to generating sufficient revenue for the functioning of our state.

Right now, according to an analysis from the Fiscal Policy Institute, we know that over 700,000 New Yorkers, with incomes under $100,000 per year, are paying over 10% of their income in property taxes (see charts below). We also know that about a third of those same tax payers are paying more than 20% of their income in property taxes. To not include property taxes under the commissions purview would be a disservice to the taxpayers of NYS.

The charts below clearly show how many residents are paying high percentages of their income in property taxes. It illustrates the need to include all state and local taxes when trying to determine tax burdens and issues of fairness within our current tax structure.

More than 700,000 New York lower- and middle-income households* pay 10 percent or more of their income in property taxes. A quarter million pay 20 percent or more.

Household income range	Less than 10% of income	10% to 19.99% of income	20% or more of income**	10% or more of income	Total number of households in income range
	Estimated number of households whose property taxes paid in 2011 were:				
$50,000 or less	539,479	250,948	237,677	488,625	1,028,104
$25,000 or less	152,513	101,865	153,013	254,878	407,391
Above $25,000 but not above $50,000	386,966	149,083	84,664	233,747	620,713
Above $50,000 but not above $100,000***	832,026	N/A	N/A	213,667	1,045,693
TOTAL: All $100,000 or less	1,371,505	N/A	N/A	702,292	2,073,797

Notes: *Estimates are for homeowning households with income of $100,000 or less and who meet the 5-year residency requirement in the Galef/Little and Krueger/Engelbright Circuit Breaker proposals. **This column, for the $25,000 or less income category, includes households with zero or negative income that paid property taxes in 2011. *** The subtotal of all households in this income range paying 10% or more of income in property taxes in 2011 includes (a) households that paid between 10% and 19.99% of income in property taxes; and (b) households that paid $10,000 or more in property taxes and who, because of top coding, can not be apportioned between the "10% to 19.99% of income" category and the "20% or more of income" category.

Source: Fiscal Policy Institute analysis of microdata from the U.S. Census Bureau's 2011 American Community Survey.

Nearly half of New York households* with incomes of $50,000 or less pay 10 percent or more of their income in property taxes.

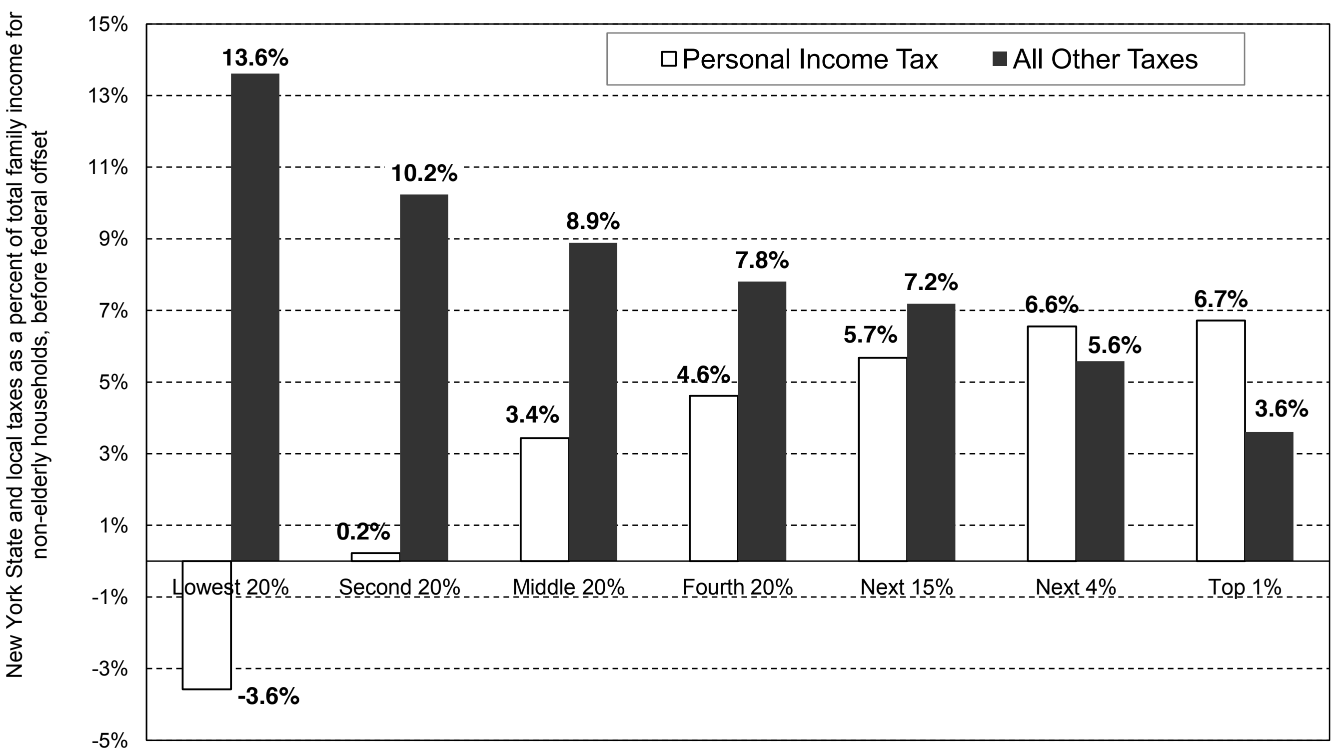
Household income range	Less than 10% of income	10% to 19.99% of income	20% or more of income**	10% or more of income
	Estimated percent of households whose property taxes paid in 2011 were:			
$50,000 or less	52%	24%	23%	48%
$25,000 or less	37%	25%	38%	63%
Above $25,000 but not above $50,000	62%	24%	14%	38%
Above $50,000 but not above $100,000***	80%	N/A	N/A	20%
TOTAL (All) $100,000 or less	66%	N/A	N/A	34%

Notes: *Estimates are for homeowning households with income of $100,000 or less and who meet the 5-year residency requirement in the Galef/Little and Krueger/Engelbright Circuit Breaker proposals. **This column, for the $25,000 or less income category, includes households with zero or negative income that paid property taxes in 2011. *** The subtotal of all households in this income range paying 10% or more of income in property taxes in 2011 includes (a) households that paid between 10% and 19.99% of income in property taxes; and (b) households that paid $10,000 or more in property taxes and who, because of top coding, cannot be apportioned between the "10% to 19.99% of income" category and the "20% or more of income" category.

Source: Fiscal Policy Institute analysis of microdata from the U.S. Census Bureau's 2011 American Community Survey.

The charts below also show that New York's income tax is progressive but not progressive enough at the top end of the income distribution to move the overall tax system to proportionality. For the lowest income 20 percent of non-elderly households, the income tax is estimated to be, on average, a negative 3.6 percent. That means that enough of the people in this quintile are working families with children to qualify for enough in refundable Earned Income Tax Credits (EITCs) to equal 3.6 percent of the income of all the households in this category including those who do not qualify for refundable EITCs. The impact of this negative 3.6 percent income tax figure is to reduce the overall tax burden for this quintile to 10 percent of income. This may be more than such low income families should be paying in state and local taxes but only the top one percent of households, those with incomes above $550,000 paid less of their income, on average (9.4 percent), in state and local taxes. And, as Figure 6 shows, the top one percent of households benefited significantly from the federal deductibility of state and local income and property taxes that reduced their overall effective state and local tax rate from 9.4 percent to 7.2 percent.

New York's income tax is progressive, but not progressive enough to balance out the regressivity of the rest of the state-local tax system.



Note: Data is for current "permanent law" tax provisions at 2010 income levels.

Source: Institute on Taxation and Economic Policy, January 2013.

Recommendations on Property Taxes:

The antiquated property tax system is inherently inequitable and increasingly unworkable as a funding mechanism for our schools and municipalities in the 21st century, and the state's over-reliance on this system demands fundamental change. With the advent of the property tax cap, the situation has now reached a crisis level for educators, students, parents and municipalities as well as for property taxpayers. Long term, we need a gradual transition of school/municipal funding from the property tax to a mix of broad-based state taxes more closely aligned with an ability to pay. Short term we must provide relief to homeowners that need relief – this can be done through a targeted property tax circuit breaker. I urge you to pass S3266 to provide targeted tax relief to people who need it the most right now.

Restoring Progressivity to the Personal Income Tax

Some of the revenue lost to the 1994-2006 tax cuts, and some of the New York tax system's lost progressivity, were both restored – on a temporary basis - by the enactment in May 2009 of a three-year increase in the top rates on the state's top Personal Income Tax (PIT). These temporary rate increases were continued - at a slightly reduced level – for 2012 through 2014 by a December 2011 enactment.

In the early 1970s, New York's top PIT rate was 15.375 percent. By 1997, that top rate had been reduced by more than 50 percent to 6.85 percent. The state's "permanent" top PIT rate is still at that 6.85 percent level but, for 2009 through 2011, the top rate was set at 8.97 percent for returns with taxable incomes (that's income after exemptions and deductions) above $500,000.

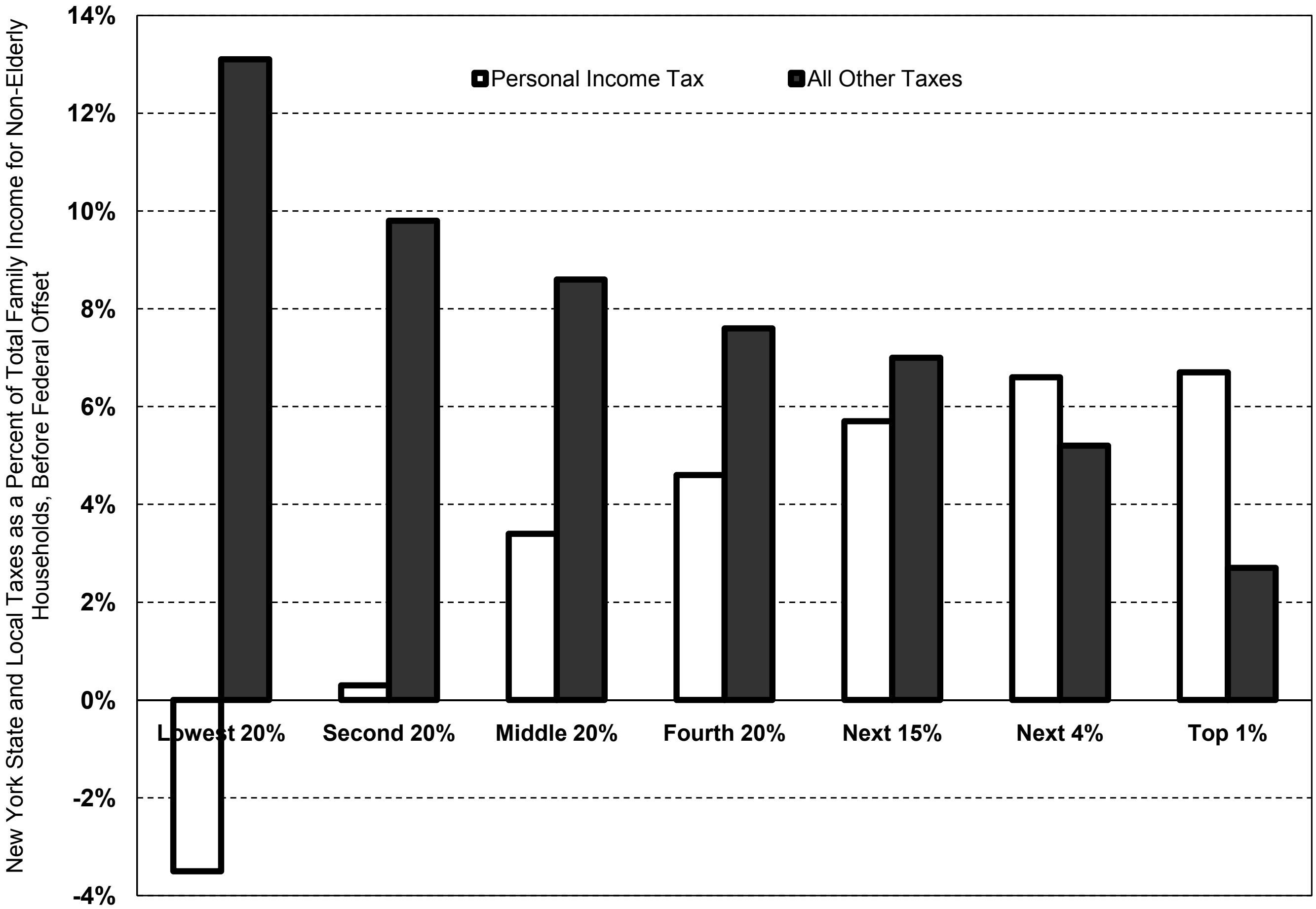
In December 2011, that temporary top PIT rate was reduced slightly while the starting point for the top bracket was increased from $500,000 to $2 million for married couples and $1 million for single taxpayers. The result was twofold. First, the state's highest income families saw their tax rate decline modestly from 8.97 percent in 2011 to 8.82 percent in 2012. Second, a substantial tax cut (a 23.6 percent reduction from 8.97 percent in 2011 to 6.85 percent in 2012) went to families with taxable incomes of between $500,000 and $2 million and individuals with taxable incomes between $500,000 and $1 million - roughly the bottom half of the top one percent of the income distribution.

Families with taxable incomes below $300,000 were not affected by the temporary rate increase put in place for 2009 through 2011. Those families with taxable incomes between $40,000 and $300,000 did, however, benefit from modest temporary rate reductions for 2012 through 2014, from 6.85 percent to 6.45 or 6.65 percent, depending on their income level.

In December 2011, at the time that the temporary PIT rates for 2012 through 2014 were enacted, Governor Cuomo was particularly critical of the state's "permanent law" bracket structure for applying the same top marginal PIT rate of 6.85 percent to families with taxable incomes only slightly above $40,000 (and individuals with taxable incomes slightly above $20,000) as it applied to families with incomes of $20 million.

While praising the temporary rates put into place for 2012 through 2014, the Governor also announced that he would create a Tax Reform and Fairness Commission to recommend a set of PIT brackets and rates for the long haul. This commission, which the Governor appointed in December 2012, is now beginning its work. We urge it to develop a more graduated rate structure for families with taxable incomes within the $300,000 to $2 million range (and for single individuals with taxable incomes between $200,000 and $1 million). All taxpayers in these income ranges are currently at a single marginal rate of 6.85 percent before the jump to 8.82 percent for married couples with taxable incomes above $2 million (and for individuals with taxable incomes above $1 million). We also urge this commission to consider additional brackets and rates for taxable income ranges above $2 million – such as $2 to $5 million, $5 million to $10 million, $10 million to $25 million, etc.

4. New York's income tax is progressive, but not progressive enough to balance out the regressivity of the rest of the state-local tax system.



Source: Institute on Taxation and Economic Policy, 2009. Note: 2007 tax law updated to reflect changes in law enacted through October 2009.

Permanent Law:

Married filing Jointly	Rate
0-$16,000	4.00%
$16,000 - $22,000	4.50%
$22,000 - $26,000	5.25%
$26,000 - $40,000	5.90%
Over $40,000	6.85%

Temporary Surcharges 2009-2011:

Married Filing Jointly	Rate
0 - $16,000	4.00%
$16,000 - $22,000	4.50%
$22,000 - $26,000	5.25%
$26,000 - $40,000	5.90%
$40,000 - $300,000	6.85%
$300,000 - $500,000	7.85%
Over $500,000	8.97%

Additional yield over permanent rate structure: 4.7 -$5.5 billion

Temporary Rate Structure 2012-2014 (enacted December 2011)

Married Filing Jointly	Rate
0 - $16,000	4.00%
$16,000 - $22,000	4.50%
$22,000 - $26,000	5.25%
$26,000 - $40,000	5.90%
$40,000 - $150,000	6.45%
$150,000 - $300,000	6.65%
$300,000 - $2 million	6.85%
Over $2 million	8.82%

Additional Yield over permanent rate structure: Approximately $2.6 billion

Fiscal Policy Institute Proposal

Married Filing Jointly	Rate
0 - $16,000	4.00%
$16,000 - $22,000	4.50%
$22,000 - $26,000	5.25%
$26,000 - $40,000	5.90%
$40,000 - $300,000	6.85%
$300,000 - $500,000	6.85%
$500,000 - $665,000	6.85%
$665,000 - $1,000,000	7.85%
$1,000,000 - $5,000,000	8.85%
$5,000,000 - $10,000,000	9.35%
$10 million - $100 million	9.85%
Over $100 million	9.99%

Additional yield over permanent rate structure: Approximately $4.4 -$5.1 billion

The tax cuts enacted for 2012-2014 provided the biggest tax reductions to married couples with taxable incomes between $500,000 and $2 million, and single individuals with taxable incomes between $500,000 and $1 million.

Taxable Income Range *	NYS Personal Income Tax Rates for Married Couples Filing Joint Returns			
	2009 to 2011	2012 to 2014	Percentage Point Change	Percent Change
Up to $16,000	4.00%	4.00%	No change	No change
$16,000 to $22,000	4.50%	4.50%	No change	No change
$22,000 to $26,000	5.25%	5.25%	No change	No change
$26,000 to $40,000	5.90%	5.90%	No change	No change
$40,000 to $150,000	6.85%	6.45%	-0.40%	-5.8%
$15,0000 to $300,000	6.85%	6.65%	-0.20%	-2.9%
$300,000 to $500,000	7.85%	6.85%	-1.00%	-12.7%
$500,000 to $2,000,000	8.97%	6.85%	-2.12%	-23.6%
$2,000,000 and above	8.97%	8.82%	-0.15%	-1.7%

Note: * In 2013 and 2014, these brackets will be adjusted based on changes in the Consumer Price Index. Under current law, the 2014 brackets will carry over to 2015 and beyond.