Dear Legislator,

I am writing on behalf of the Citizens Budget Commission to recommend legislative actions on the tax relief and reform proposals in the Executive Budget for fiscal year 2015. We support the Executive Budget reforms to New York’s business, estate, and utility taxes; we recommend that action on the property tax relief proposals be deferred until their design is improved and until the surplus necessary to sustain them is actually achieved.¹

Desirable Business, Estate, and Utility Tax Reforms

Three measures in the Executive Budget will improve New York’s tax policies.

Corporate and Bank Tax Unification. New York’s corporate and bank taxes were established in the 1940s and have not been significantly updated in more than 25 years. The complex structure of the separate bank tax, unusual among states, does not reflect the restructuring that is underway in the financial services industry, leading to lengthy audit proceedings.² The three-factor formula for calculating the bank tax leads to tax avoidance and less employment in New York as institutions seek to lower their tax burden by lowering their in-state payroll.

For many years the Department of Taxation and Finance has worked to advance the simplification of the corporate franchise tax and its merger with the bank tax; its proposals were incorporated in the recent Final Report of the New York State Tax Reform and Fairness Commission. Under the proposal, banks, like corporations, would be taxed according to a single sales factor that apportions the tax by sales to customers in New York, a structure that many other states have adopted to help eliminate tax-avoidance.

In addition to merging the bank and corporate franchise taxes, the proposal would reduce New York’s corporate tax rate from 7.1 percent to 6.5 percent effective January 1, 2016. The estimated receipts loss from the reduction is $346 million by fiscal year 2018. Although the Tax Reform and Fairness Commission did not recommend lowering the rate this year, it did note a "strong sentiment within the Commission... that corporate tax reform... would generate increased economic


activity in New York, leading to increased corporate tax revenues." Although it is not clear that a rate reduction in this tax is a high priority, it is a constructive accompaniment to the simplification reform with relatively modest associated revenue losses.

**Estate Tax Reduction.** Also consistent with the recommendations of the Tax Reform and Fairness Commission, the Executive Budget proposes to phase in over four years changes to New York’s estate tax that conform it to federal policy and reduce its rate, and thereby make it less burdensome. New York’s estate taxes are out of step with federal policy, which has changed substantially over the last 15 years. Federal law excludes estates with a value up to $5.25 million; New York’s threshold is just $1 million to trigger a rate of 16 percent. Federal tax changes have also eliminated the deduction of state estate taxes from the federal tax owed, thereby making them additive to an already substantial federal estate tax. Many states responded by eliminating their estate taxes, leaving only 14 states including New York that continue to levy an estate tax. Although economists continue to debate the impact of taxation on location decisions, lowering the top tax rate to 10 percent could encourage some wealthy residents to remain in New York.

**Accelerated Phase-Out of Utility Surcharge.** In 2009, in response to revenue declines during the Great Recession, a temporary 2 percent surcharge was levied on electric, gas, water, and steam utilities. Under current law the surcharge will phase out by 2018. The surcharge is passed along to customers and has been particularly burdensome to businesses that are large users of power. The Executive Budget proposes to eliminate the surcharge immediately for industrial customers and accelerate the phase out for all others; this is affordable and will improve New York’s economic competitiveness.

**Premature and Problematic Property Tax Relief Measures**

The Executive Budget proposes three property tax-related measures that, when fully implemented, would replace about $1.4 billion of local property tax collections with State tax revenue. These proposals are not are well targeted to provide relief to the most burdened New Yorkers, and they do not alter substantially the high cost of local government that drives high property tax burdens in the state.

First, a new Real Property Tax Freeze Credit is proposed for fiscal years 2015 and 2016 for homeowners with incomes up to $500,000 who live in school districts and municipalities that agree to stay within the previously enacted property tax cap. The credit is 2 percent of the tax liability and is expected to cost $1 billion annually statewide. The credit would be provided in the form of a check to taxpayers issued by the Department of Taxation and Finance after property taxes are paid. In the second year the credit would be available only to homeowners in local government units that remain within the property tax cap and submit consolidation or shared services plans that show 1 percent, 2 percent, and 3 percent reductions, respectively, in the property tax levy in the three following years.

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When the freeze credit expires after two years, it would be replaced by the second initiative, a permanent Enhanced Real Property Tax Circuit Breaker Credit. It would provide a personal income tax credit to taxpayers residing in local jurisdictions that stay within the property tax cap. Homeowners with incomes up to $200,000 whose property taxes exceed specified percentages of gross household income would be eligible for credits related to their property tax burden up to a maximum of $1,000.

Finally, a new Renter’s Credit is proposed to provide a personal income tax credit for families with incomes up to $100,000 and senior citizens with incomes up to $50,000. When fully phased in during the 2015 tax year, the maximum annual credit for those in the lowest income band ($25,000 or less) would be $220 for senior citizens and $370 for a family of four. The initiative is estimated to cost $400 million annually; 67 percent would be provided to renters in New York City.

Although New York’s high property taxes are a legitimate concern, these proposals suffer from design flaws that compromise their effectiveness.

1) The proposals offer relief that is shallow and not sufficiently targeted to homeowners and renters facing the greatest burdens. The two-year Freeze Credit would provide the greatest benefit to those with incomes near the top of the $500,000 income eligibility limit living in expensive homes in high cost communities. A 2 percent reimbursement would be larger in dollar terms on a $1 million property than on a $200,000 property. Lower income homeowners, particularly those living in areas upstate, would receive the smallest checks even though in some counties their property taxes as a percentage of home value are among the highest in the nation. Moreover, because the Freeze Credit is temporary, its benefits will quickly dissipate unless recurring property tax savings are achieved in the near-term, an unlikely prospect for reasons discussed below.

The Enhanced Circuit Breaker Credit is better structured to assist homeowners with the highest burdens, but its benefits are thinly spread across homeowners with incomes up to $200,000. Circuit breakers have three features that drive relief – the trigger threshold that determines the “overburden,” the percentage of the overburden relieved, and the maximum allowable credit. All three features of the proposal are set to deliver broad, shallow relief. The trigger is low, set at 3, 4, or 5 percent of income. The percent of the overburden relieved is low, ranging from 10 to 20 percent depending on income. And the credit cap is relatively low, a maximum of $1,000. For example, a homeowner with a $175,000 gross household income and a $10,000 property tax bill would receive a $125 credit. At the other end of the spectrum, homeowners with very low incomes and very high proportional property tax burdens would find their benefit limited by the $1,000 maximum.

The proposed Renter’s Credit has similar flaws. It would generate small benefits to those at the top of the $100,000 income eligibility threshold, while limiting benefits for lower income renters.
For example, a family of four with an annual income of $90,000 would receive a credit of $162, while a family of four with a $50,000 income would receive a credit of $182.\(^4\)

2) The proposals are cumbersome to administer, inviting implementation problems for the State as well as taxpayer dissatisfaction. The Freeze Credit and the Enhanced Circuit Breaker Credit would be provided only to homeowners who live in jurisdictions that remain under the property tax cap and, in the case of the Freeze Credit, have also developed approvable shared services or consolidation plans. For homeowners, this could lead to inequitable treatment of those who face substantial property tax burdens but, through no fault of their own, live in jurisdictions that fail to meet these requirements.

For the Department of Taxation and Finance, the proposals present serious implementation challenges. For example, the Department will have to track the compliance of thousands of local government units in staying under the cap, and then calculate benefits and issue rebate checks to eligible homeowners. While the Enhanced Circuit Breaker Credit would be provided through a credit on state personal income tax returns, it invites administrative headaches in determining eligibility and credit amounts in cases where a homeowner resides in one taxing jurisdiction such as a school district that remains within the cap, but also in another jurisdiction such as a county or town that does not. A state aid intercept is included as a “clawback” from local governments that fail to meet the savings targets, but it is unclear who will determine whether the intercept is needed. The Department of State is responsible for reviewing all proposals in the two-month period from June 1 to July 31, 2015, but a longer-term fiscal monitoring effort will be needed to oversee the plans through 2019.

3) The Freeze Credit Rebate and Enhanced Circuit Breaker Credit are not likely to address the high costs of local government that drive property taxes. Local property taxes are a function of local costs. Although the state can rebate some of the tax to alleviate the pressure on particular households, such measures only shift payment from local to statewide taxpayers. In an effort to lower costs, the Executive Budget proposals place strong emphasis on local shared services and consolidation plans to achieve a goal of 3 percent tax levy savings in 2019. While these measures can be an important part of an effort to control property tax growth, it will be difficult for the thousands of localities across the State to develop such plans within the required 15-month period. In addition, localities that implemented shared services prior to the timeline for the new consolidation plans will receive no credit for these efforts.

In contrast, the proposals make no attempt to address the high cost of salaries, wages and fringe benefits that comprise two-thirds of local budgets. In addition, local governments bear the burden of large unfunded mandates such as a share of Medicaid program costs. An effective method of reducing local government expenses and hence, tax burdens, would be to further reduce the local

\(^4\) Unlike the existing circuit breaker program for renters, relief calculations in the proposal are determined by age, number of dependents, and federal adjusted gross income in the household, not on a percentage of rent assumed to be attributable to property taxes.
share of Medicaid. As cost containment efforts put in place by the Medicaid Redesign Team bear fruit, the State is well positioned to reduce the overall tax burden for the program.

Thank you for considering our recommendations. Please do not hesitate to contact me or my staff at 212-279-2605 with any questions.

Sincerely,

Carol Kellermann
President