



# Practical Policy in Challenging Circumstances:

How New York State and New York City Should Respond to the Tax Cuts and Jobs Act

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## EXECUTIVE SUMMARY

The Tax Cuts and Jobs Act (TCJA) makes significant changes to personal income and business taxes that will have major impacts on the residents and revenues of New York State and New York City. Decisive action is needed, yet the full implications of TCJA will not be known for quite some time. Given the imperative, the State and localities should rapidly implement responses to immediate issues, conduct sufficient analyses to design and implement responses where the issues are more complex, monitor the impacts of TCJA, and be nimble in adjusting policy going forward as warranted.

New York's leaders must focus on two main problems to protect the State and the City:

1. **The SALT cap makes New York less competitive for residents and businesses.** TCJA caps a taxpayer's deduction of state and local taxes (SALT) paid at \$10,000 (SALT cap) and will increase taxes for many New Yorkers. In total, the SALT cap is estimated to cost New Yorkers between \$9.5 billion and \$15.3 billion in additional federal taxes, reducing the federal tax cut they would otherwise receive or, in many cases, resulting in a federal tax increase.

The SALT cap also will increase the already large gap between New York's and other jurisdictions' state and local taxes. Neighboring states, such as Pennsylvania and Massachusetts, have lower and flat tax rates, and other jurisdictions do not have a personal income tax at all. For example, the SALT cap widens the gap between the cost of living in New York and Florida by \$33,000 for a taxpayer earning \$1 million, and a notable \$423,000 for someone earning \$10 million.

This cost differential hurts New York's competitiveness as a place to live and conduct business, particularly for high income earners who make up so much of the tax base. New York State taxpayers earning more than \$500,000 annually pay 49 percent—\$21.0 billion—of the State's personal income taxes. Losing 2 percent of these taxpayers would reduce annual State income tax revenues by more than \$421 million. A 2 percent reduction of similar New York City taxpayers would reduce City income tax revenues by more than \$100 million. The widened cost differential may encourage New Yorkers to change their residences and discourage potential new residents from migrating here, both reducing tax revenue and forgoing the opportunity for New York to be the home of businesses these individuals control or would create.

2. **New York State tax conformity could drive \$1 billion in unplanned State personal income tax and \$109 million State business tax increases.** New York State and New York City use federal personal income tax definitions of adjusted gross income (AGI), exemptions, deductions, and credits as a base for calculating New York taxable income and liability. TCJA's changes are projected to result in an unplanned \$1 billion increase in New Yorkers' State tax liability, and a \$320 million unplanned increase in New Yorkers' City tax liability.

Despite the sweeping nature of the federal business tax changes, the direct impact on New York's businesses due to conforming to federal definitions is expected to total \$109 million, including one-time revenue. The recurring increase would be less than 1.5 percent of corporate income tax receipts.

## Recommendations

The potential negative impact of federal tax reform on New York has prompted a wide range of proposals, divergent opinions, and lively public debate. New York should not allow counterproductive federal tax policy to drive unsound State and local tax policy and should move quickly with solutions to address immediate problems, but also allow time for deeper analysis and experience for complex issues.

The following five strategies will help the State and the City mitigate the negative impacts of the SALT cap, address the unplanned tax increases, and set the stage for future action.

**1. Selectively decouple from federal definitions and continue to conform to others for at least one year to allow evaluation and additional reform.**

The Governor has proposed selectively decoupling from all elements that drive the unplanned tax increase. The State should proceed with decoupling from the personal exemption, enhanced child tax credit, and the SALT cap since these would be relatively easy to administer and would relieve New Yorkers of \$740 million of unplanned tax increases.

Since conformity to the federal tax system makes filing easier for taxpayers and alleviates the State's burden of independently verifying itemized deductions, the State should not immediately decouple from the standard deduction, miscellaneous deductions, medical expense deduction, and alimony changes. This would result in a one-year net \$300 million State tax increase that would primarily fall on higher income New Yorkers. The State should use this year to evaluate whether reforms could more effectively reduce unplanned tax increases while remaining conformed to the federal code.

**2. Blunt the impact of the SALT cap to maintain competitiveness.**

*2a. Create an optional Employer Compensation Expense Tax (ECET).*

The State should adopt a phased-in ECET, which would be optional for employers. The Governor proposed to implement an ECET on businesses on employee wages in excess of \$40,000, phased up to a 5 percent rate over three years. CBC recommends that the ECET apply to wages above a higher salary threshold, perhaps \$200,000, and phase up to a higher rate, perhaps 6.65 percent. Employees would receive a credit against their State income tax (which would increase their after tax income) and would have a lower gross salary, which would reduce their federal taxes. New York City should create an ECET as well, appropriately reflecting its tax rates.

If half those affected by the SALT cap were covered by the ECET, the Governor's proposal could offset 14 percent of the SALT impact. CBC's recommendation could save covered New Yorkers another \$330 million. There are challenges to creating and implementing an ECET, particularly at the lower end of the salary scale. CBC recommends the higher wage threshold and tax rate since they would be easier to implement, better targeted to the main problem, and may garner higher uptake. The State should take the time to conduct sufficient analysis and obtain broad input. This does not need to be adopted with the State's budget; midyear adoption would still provide time for the ECET to go into effect for 2019.

*2b. Create the opportunity for taxpayers to receive tax credits for charitable contributions for public education and health purposes.*

The State and localities should create charitable education and health funds, to which taxpayers can make federal and State-deductible contributions and receive partial State and local income and property tax credits. Legislation to create these funds must establish a mechanism to ensure those funds are appropriated, expended, and reported in the budget appropriately and transparently.

These contributions can offset the impact of the SALT cap on high-income earners significantly: A filer earning \$10 million and contributing \$1.15 million to State and local health and education funds could save more than \$300,000, primarily from lower federal tax liability. While beneficial, the viability of this strategy is uncertain since it may be challenged in the courts or by an adverse federal IRS ruling.

*2c. Create a business tax on pass-through entities – an Unincorporated Business Tax (UBT).*

Nineteen percent of the income of those with AGI more than \$1 million is from partnership and S-corporation income; thus, a UBT would complement the ECET which applies to wage income. If all State and local taxes on partnership and S-corporation income were paid by the business and not the owner(s), a UBT could alleviate roughly 17 percent of the total SALT cap impact.

Designing a UBT will take time and will entail defining how income is sourced, expenses are attributed, whether or not it should be optional, and how payment to partners would be audited. A State UBT also would overlay New York City's current (and problematic) UBT, adding additional design and communication challenges. Any State proposal should be shared and vetted publicly to minimize unintended consequences.

**3. Limit action on business taxes to the proposed technical fix.**

The change proposed by the Governor ensures corporate taxpayers will not be allowed a deduction associated with deemed-repatriated income, since New York will not tax that income. The ease of administration outweighs the relatively minor unplanned tax increase caused by conformity to federal business tax definitions.

#### **4. Leverage this opportunity to consider further reforms.**

*4a. Consider reforming the estate tax to address New York's attractiveness to high-income households.*

Currently, New York is 1 of only 12 states that impose an estate tax. Reform could reduce rates, increase the exemption, fix the "cliff" that results in a greater than 100 percent marginal rate on certain estates, or repeal the tax entirely. Reforming the estate tax could help dissuade wealthy New Yorkers from leaving the Empire State for lower taxed locales and is of heightened importance given the impact of the SALT cap.

*4b. Control spending to reduce the need for high State and local taxes.*

Both New York State and New York City are high spending and high taxing jurisdictions. In some ways this reflects local preference for service provision; however, it also is a function of spending growth without increasing productivity or effectiveness.

*4c. Consider broader reforms to simplify the tax system.*

Federal tax reform is an opportunity for State policymakers to rethink New York's tax system, as was true after the 1986 federal changes. Opportunities to consider include broadening bases and lowering rates, shifting from reliance on the income tax, increasing federal conformity, and increasing fairness in the New York City property tax system.

#### **5. Monitor the effects of TCJA and State and City responses.**

TCJA and the State and City responses will have predicted and unforeseen impacts that could be significant. Financial and legal interpretation will have substantial effects and behavioral and economic impacts will play out over time. The State and the City must monitor these effects, including resident migration, and adjust policy as needed to promote competitiveness, fairness, and good fiscal policy.

## **Conclusion**

State and City leaders should take decisive action to maintain competitiveness and protect New Yorkers. These recommendations include steps needed to address the problems created by the TCJA and to signal that New York is a desirable place to live, work and run a business. The recommendations are, however, less than perfect. Given the challenges presented by TJCA, New York cannot let the perfect be the enemy of the practical and urgent. The State and localities should implement responses, monitor impacts, and make changes as needed. To the extent that responses face legal challenges or do not get significant uptake, the imperative to control spending and further reform the tax system increases.



## INTRODUCTION

On December 22, 2017, the federal government enacted the most sweeping set of tax reforms in a generation—Public Law 115-97, more commonly known as the Tax Cuts and Jobs Act (TCJA).<sup>1</sup> TCJA includes significant changes to personal income taxes and business taxes, particularly in relation to income earned from international sources. In addition to the much debated impacts on the national economy and federal deficit, TCJA will have major impacts on the residents and revenues of New York State and its localities, including New York City.

TCJA's personal income tax changes include rate and bracket reductions and changes to exemptions, deductions, and credits. Taking effect in 2018 and with most scheduled to sunset after 2025, these changes are projected to decrease federal personal income tax liability by \$1.1 trillion from 2018 through 2027.<sup>2</sup> Because many states and cities, including New York, conform to elements of the federal tax system, the changes will have significant direct impacts on state and local government revenues. The major changes to the personal income tax system include:<sup>3</sup>

- Reducing marginal rates, including a top rate reduction from 39.6 percent to 37 percent;
- Increasing the standard deduction from \$6,350 to \$12,000 for single filers and from \$12,700 to \$24,000 for those married filing jointly;
- Eliminating personal exemptions;
- Enhancing the child tax credit, including doubling the credit for children under age 17 from \$1,000 to \$2,000;
- Increasing the alternative minimum tax (AMT) threshold and phase-out levels;
- Capping the deduction for State and local taxes (SALT) at \$10,000 (SALT cap);
- A 20 percent deduction for pass-through income under certain circumstances;
- Doubling the estate tax exemption from \$5.6 million to \$11.2 million for singles and from \$11.2 million to \$22.4 million for couples;
- Reducing the ceiling on the mortgage interest deduction from mortgages of \$1 million to \$750,000;
- Eliminating certain miscellaneous deductions, including investment fees, tax preparation fees, unreimbursed business expenses, investment expenses from pass-through entities, among others; and
- Reducing the threshold for deducting medical expenses from 10 percent to 7.5 percent of adjusted gross income (AGI) for 2017 and 2018.

Since New York State and New York City conform to many federal definitions, these have a direct effect on New Yorkers' State and local tax liability and State and City tax revenue. In particular the deductibility of state and local taxes has been a relatively unchanged feature of the federal tax system for more than 100 years. Capping this deduction is a major change and will increase the

federal tax liability of many New Yorkers. It will dramatically increase the tax differential between living in New York and lower tax states such as Florida and Texas, a direct strike at New York's competitiveness for residents and business.

TCJA also made major changes to business taxes, including reducing the corporate tax rate and changing the taxation of international business activities. Between 2018 and 2027, these permanent changes are projected to decrease federal revenue by \$653 billion, offset by \$325 billion generated by the international tax changes. Specific changes include:<sup>4</sup>

- Reducing the federal corporate income tax rate from 35 percent to 21 percent;
- Eliminating the corporate AMT;
- Shifting from a worldwide to a territorial tax system; and
- Changes related to net operating losses, temporary expensing of certain business capital investments, limits on certain deductions, and accounting requirements.<sup>5</sup>

Some New York State business tax elements conform to federal tax definitions, and as a result, these changes affect State tax revenue. Importantly, the corporate and personal tax changes may affect choices businesses make about their legal forms of organization. Some firms and individuals may organize as "C Corporations," in part to take advantage of the corporate tax rate reduction, while others may become partnerships to take advantage of the 20 percent deduction of pass-through income.<sup>6</sup>

As with any substantial tax reform, the actual impacts will vary from the initial predictions. Still, the direct impacts will be substantial, and New York State and New York City should take steps to preserve competitiveness and protect residents from harmful consequences.

These steps are already in motion. In January the New York State Department of Taxation and Finance (DTF) released a "Preliminary Report on the Federal Tax Cuts and Jobs Act" (DTF Preliminary Report) that presented several options the State and its localities should consider in response to the TCJA.<sup>7</sup> In his Executive Budget and subsequent 30-day Amendments, Governor Andrew Cuomo proposed specific measures to selectively decouple the State's personal income tax, reduce the negative impact of the SALT cap, and make technical changes to business taxes. Since New York City's tax system and tax policy are in large part defined by State law, the City and the State are in active discussion about adopting coincident measures.

To analyze the TCJA and identify and evaluate options for appropriate State and local government action, in December 2017 the Citizens Budget Commission convened a Special Committee consisting of CBC trustees, business and civic leaders, and policy experts. (See Appendix 1.) The Committee oversaw the work of CBC staff and consultants and provided the guidance that shaped the recommendations in this report.

This paper first identifies the TCJA impact on New York and the most critical problems. It then identifies guiding principles that New York's leadership should consider in designing and implementing solutions. Finally, it recommends five actions that will protect New Yorkers now and set the stage for the future.



## IMPACT AND SIGNIFICANT PROBLEMS

The TCJA will have significant ramifications for individuals, businesses, public revenues, and the economy. Some effects will be direct, like those on individual tax liability. Others will be indirect, including the effect of lower rates on business investment decisions and the effect of the SALT cap on business and individual location decisions.

There are two problems that are most significant:

### **First, the SALT cap makes New York less competitive for residents and businesses.**

Since the creation of the federal income tax in 1913, income and property taxes paid to state and local governments have been deductible from income when calculating a taxpayer's federal income tax liability. This effectively reduces the cost of state and local taxes for itemizing taxpayers.

The SALT cap will affect many, but not all, New Yorkers. In 2015 nearly 35 percent of all New York State filers itemized their federal taxes and claimed \$73.6 billion in SALT deductions. The average New York filer who deducts State and local taxes pays more than \$22,000 in SALT annually. However, the amount varies greatly between income brackets, with lower income New Yorkers paying slightly more than \$5,000 annually while those with AGI more than \$1 million pay an average more than \$500,000 annually.<sup>8</sup>

Estimating the total impact of the SALT cap is challenging given a) data limitations, b) the increase in the standard deduction which will reduce the number of filers who will itemize, and c) the increase in the threshold for the AMT.<sup>9</sup> New York State has estimated that the SALT cap will cost New Yorkers an extra \$14.3 billion annually. CBC's analysis indicates that it may cost New Yorkers between \$9.5 billion and \$15.3 billion, reducing the federal tax cut they would otherwise receive or, in many cases, resulting in a federal tax increase.<sup>10</sup>

The SALT cap will drive actual federal tax increases for a portion of primarily higher income New Yorkers. Many of the approximately 517,000 taxpayers with AGIs more than \$200,000 annually will face federal tax increases. Refining this number is challenging because many had already lost their SALT deductions because of AMT.<sup>11</sup> Furthermore, the impact varies by individual circumstance. For example, a single renter with \$350,000 in income will likely see a slight federal tax increase while a married homeowner with two children and a similar income will likely receive a cut. Most of the 1.2 million taxpayers with AGI between \$100,000 and \$200,000 will likely see smaller marginal changes in either direction. The overwhelming majority of the 7.9 million New Yorkers reporting AGI less than \$100,000—who represent 82 percent of all taxpayers—will receive a federal tax cut.

For New York City, the New York City Department of Finance estimates that 10 percent of filers will see a tax increase.<sup>12</sup> The New York City Comptroller estimates that half of those earning between

\$100,000 and \$500,000 and 58 percent earning more than \$1 million will have increases.<sup>13</sup>

The SALT cap also will increase the effective cost of State and local government services at the margin; each new dollar of State and local government spending will cost New York taxpayers more than under previous federal law.

Significantly, the SALT cap will increase substantially the already large gap between New York's and other jurisdictions' state and local taxes, making New York less competitive for resident and business. Effectively increasing the relative cost of State and local taxes provides an incentive for high earning New Yorkers to change their residences and a disincentive for others to come to New York. State and City responses should focus on this cohort, since migration of high earners, and possibly the businesses they control, could have an acute impact on the tax base.

High earner mobility is not a new phenomenon. Even before TCJA, high earners who contributed the bulk of State income tax revenues appeared to be leaving New York State. Between 2010 and 2014, the number of nonresident New York State filers with incomes between \$1 million and \$10 million increased from 26,877 to 39,817, or 48 percent, substantially higher than the 33 percent increase in residents in this income range. During that period nonresident filers with incomes more than \$10 million increased from 2,069 to 3,616, or 75 percent, compared to 49 percent for residents.<sup>14</sup>

By dramatically increasing the tax differential of New York with lower tax jurisdictions, the SALT cap will likely exacerbate this trend. For example, before TCJA a taxpayer earning \$1 million paid an extra \$50,000 in SALT by living in New York City compared to Florida. The SALT cap will increase this differential \$33,000 to \$83,000. For a taxpayer earning \$10 million the differential increases \$423,000, from \$645,000 before TCJA to \$1.1 million after.<sup>15</sup> (See Appendix 2.)

While relatively few New Yorkers have earnings this high, they pay a large share of taxes. The 203,000 New York State taxpayers with AGI more than \$500,000 annually pay 49 percent—\$21.0 billion—of the State's personal income taxes.<sup>16</sup> A 2 percent reduction of this group, representing approximately 4,000 taxpayers, would reduce annual State income tax revenues by more than \$421 million. For New York City, the 56,000 filers with AGI more than \$500,000 annually pay 53 percent—\$5 billion—in City income taxes.<sup>17</sup> A 2 percent reduction of this group, representing approximately 1,100 taxpayers, would reduce annual City income tax revenues by more than \$100 million.

While New Yorkers earning less than \$500,000 who receive a federal tax increase due to the SALT cap are unlikely to move in the near term, over time the tax disparity with other states may reduce the desirability of living and working in New York, potentially hampering the labor market and New York's attractiveness to business.

## **Second, New York State tax conformity could drive unplanned \$1 billion in State personal income tax and \$109 million in State business tax increases.**

New York State and New York City use federal personal income tax definitions of AGI, exemptions,

deductions, and credits as a base for calculating New York taxable income and liability. TCJA's changes are projected to result in an unplanned \$1 billion increase in New Yorkers' State tax liability, and a \$320 million unplanned increase in New Yorkers' City tax liability.<sup>18</sup>

Sources of unplanned state revenue:

- *Standard Deduction Increase.* In New York State, any taxpayer who elects to take the federal standard deduction is required to take the State standard deduction. The federal standard deduction will increase the number of filers electing to use the deduction. In 2015 more than 1.7 million returns with AGI less than \$100,000 itemized deductions; many of these taxpayers, and some others, will likely no longer find it beneficial to itemize, resulting in higher State taxable income and an additional \$44 million in liability.<sup>19</sup>
- *Personal Exemption Elimination.* New York State law identifies who may take the New York nondependent standard deduction by referencing how the personal exemption is defined in the federal tax code. With the elimination of the federal personal exemption, all single filers who claim the State standard deduction will have to claim the standard deduction for dependents, which is \$4,900 lower than for nondependents, even if they are not dependents.<sup>20</sup> Absent action, this technical glitch may result in \$840 million in unplanned State tax revenue, mostly from those with incomes below \$100,000.
- *Enhanced Child Tax Credit.* Since New York State's child tax credit is linked to the federal child tax credit, the State would lose approximately \$500 million in revenue absent any changes.
- *SALT Cap.* Since the State's taxable income calculation starts with federal AGI, the SALT cap will increase State taxable income, generating \$400 million in unplanned liability and tax revenue. This would come mostly from the 517,000 filers with AGI more than \$200,000.
- *Medical Expense Deduction.* The lower threshold will allow more New Yorkers to claim this deduction, saving \$25 million in taxes. Ninety-three percent of filers who claim medical expense deductions earn less than \$150,000 annually.<sup>21</sup>
- *Miscellaneous Deduction Eliminations.* By eliminating these, New York taxpayers will report higher AGI, resulting in \$281 million of additional State tax revenue. Seventy-nine percent of filers who

**Table 1: TCJA Personal Income Tax Changes, NYS Revenue Impact**  
(dollars in millions)

	<u>Impact</u>
Standard deduction	\$44
Personal exemptions	\$840
Child tax credit	(\$500)
SALT cap	\$400
Medical expense deduction	(\$25)
Miscellaneous deductions	\$281
<b>TOTAL</b>	<b>\$1,040</b>

Source: New York State Department of Taxation and Finance, *Preliminary Report on the Federal Tax Cuts and Jobs Act* (Revised, January 23, 2018).

report miscellaneous expenses earn less than \$150,000. Only 0.9 percent of filers who report miscellaneous expenses earn more than \$1 million, but they would pay 27 percent of the tax increase.<sup>22</sup>

Despite the sweeping nature of the federal business tax changes, the direct impact on New York is expected to total just \$109 million, including \$60 million in nonrecurring revenue.<sup>23</sup> The recurring increase would be less than 1.5 percent of annual corporate income tax collections. This relatively small impact suggests the changes are unlikely to negatively affect the state’s competitiveness.

While the reduction in the federal corporate tax rate will not have direct effects on New York revenue, in conjunction with other provisions the tax cut could influence how businesses organize, which in turn could have indirect impacts on New York. But, projecting the impact at this juncture is beyond the scope of this analysis.

New York is already decoupled from most federal provisions relating to net operating losses, depreciation, and expensing. Thus, most of these federal changes would not automatically pass through to New York. Several other provisions to which New York conforms would affect revenue, including new limits on certain business interest expenses (\$45 million) and fringe benefit deductions (\$15 million), immediate expensing for small businesses (-\$18 million), and liberalizing some accounting requirements for small businesses (-\$30 million). Several international provisions also have relatively minor revenue impacts, including:

- *Deemed Repatriation-Related Interest Expense.* Interest expense attributable to Subpart F income already is disallowed in New York, so taxpayers will have to add back interest expense attributable to income deemed repatriated. The interaction of deemed repatriation with a technical provision in New York law governing calculation of this addback could generate a one-time revenue increase in New York of \$60 million.

**Table 2: TCJA Business Tax Changes, NYS Revenue Impact**  
(dollars in millions)

	<u>Impact</u>
<b>ONE TIME</b>	
Addback of interest expense related to deemed repatriated income	\$60
<b>RECURRING</b>	
Taxation of GILTI income	\$30
Limitations on business interest expenses	\$45
Limitations on fringe benefit expenses	\$15
Accounting-related changes	(\$30)
Small business expensing provisions	(\$18)
All other provisions	\$7
<b>Subtotal, Recurring Revenue Impacts</b>	<b>\$49</b>
<b>TOTAL</b>	<b>\$109</b>

Source: New York State Department of Taxation and Finance, *Preliminary Report on the Federal Tax Cuts and Jobs Act* (Revised, January 23, 2018).

- *Global Intangible Low-Taxed Income (GILTI) Inclusion and Flow-Through Deductions.* Although Subpart F income would not be taxed in New York, other foreign-source income, known as GILTI, would be subject to tax, generating \$30 million in revenue annually. The State should monitor the revenue from GILTI income, since this is a change without significant experience from which to project.<sup>24</sup>

Because New York would not tax deemed repatriated income, it presumably would not wish to allow deductions attributable to this income. Due to the interaction of federal and State law, it might be possible to interpret New York law as allowing certain deductions absent a technical change.



## GUIDING PRINCIPLES

The potential negative impact of federal tax reform on New York has prompted a wide range of proposals, divergent opinions, and lively public debate. Relying on the following five principles will help ensure remedies have maximum positive impact. While effective solutions may not perfectly adhere to all principles, considering and keeping them in balance will yield the best outcome.

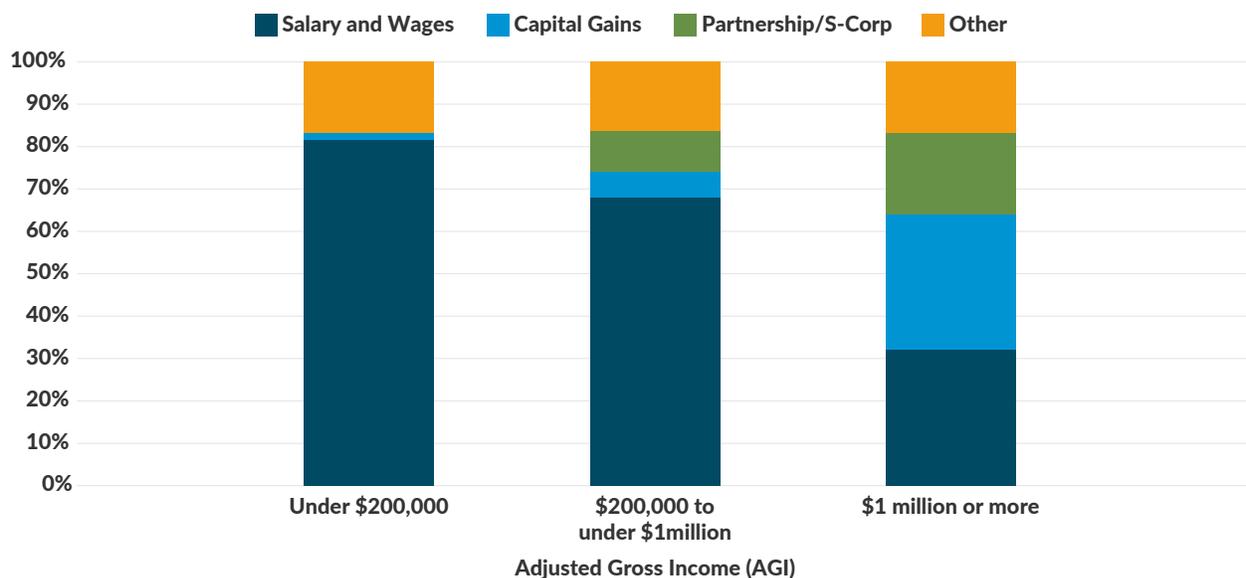
### 1. Focus on the most significant problem.

New York’s residential and business competitiveness is critical for a prosperous future for all New Yorkers. While many New Yorkers will be affected by the SALT cap, the majority will still receive an aggregate federal tax cut. The largest problem for New York’s competitiveness is that the SALT cap will significantly increase the tax differential with lower cost states for the highest income New Yorkers, increasing the incentive to change their residency and discouraging new residents and businesses from coming to the State and the City.

Targeting this segment of the population requires solutions that address both the magnitude of SALT that can no longer be deducted and the types of income these New Yorkers earn. Only 32 percent of income of New Yorkers with AGI of more than \$1 million is from wages. The majority of the balance is from net capital gains (32 percent) and partnership/S Corporation net income (19 percent).<sup>25</sup>

To maintain New York’s competitiveness, New York State and New York City would be wise to forgo options that try to capture federal personal or business tax reductions. These

**Figure 1: Components of Income for NYS Taxpayers, 2015**



Sources: 2015 data from Internal Revenue Service, Statistics of Income Division, "SOI Tax States - Historic Table 2 "Individual Master File, 15in33ny.

would increase tax differentials with other states and send a negative signal to current and potential New Yorkers, entrepreneurs, and business leaders.

**2. Do not allow counterproductive federal policy to drive unsound State and local tax policy.**

New York's fiscal and economic health will be sustained if it generates adequate revenue for important services in a prudent manner. Sound tax policy: generates adequate revenues; does not favor specific industries or individuals; treats similarly situated taxpayers the same; considers taxpayers' ability to pay; is relatively simple and economical to administer and comply with; and is accountable and transparent.

**3. Conform to the federal tax system since it generally is beneficial for taxpayers and tax administration.**

Conformity simplifies tax preparation for the taxpayer and administration for the State. For example, conformity allows a taxpayer to calculate itemized deductions once and use them for both federal and State returns. Conformity also allows the State to depend on the federal government to verify certain information, rather than take on this burden itself. Historically New York has conformed on a rolling basis to many federal tax concepts. Continuing this approach is beneficial but should be reconsidered when it has unintended liability and revenue consequences, is counterproductive, or promotes policy that diverges from local preferences.

**4. Do not compromise transparency and accountability.**

The imperative for action must not compromise transparency and accountability. New Yorkers must have full transparency as to how revenues for governmental purposes are raised and spent in accord with the oversight provided to the generation and expenditure of other public resources.

**5. Move fast with solutions to address immediate problems; allow time for deeper analysis and experience for complex issues.**

New York must act quickly given the potential negative impacts of the TCJA. However, some of the potential responses are extremely complicated, may have unforeseen consequences, and may not have the intended impact. Every major tax reform has had unpredicted effects, and there are many questions about how TCJA will unfold. These should not be discounted. How will corporate formations change to reduce business and individual taxes? What pass-through businesses will be eligible for the 20 percent deduction? Given these unknowns New York should not rush where there is substantial uncertainty and where experience and analysis will enable a better approach.



## RECOMMENDATIONS

The following five strategies will help the State and the City mitigate the negative impacts of the SALT cap, address the unplanned tax increases, and set the stage for future action.

1. Selectively decouple from federal definitions and continue to conform to others for at least one year to allow evaluation and additional reform.
2. Blunt the SALT cap to maintain competitiveness:
  - create an optional Employer Compensation Expense Tax (ECET);
  - create the opportunity for taxpayers to receive tax credits for charitable contributions for public educational and health purposes; and
  - create a business tax on pass-through entities—an Unincorporated Business Tax (UBT).
3. Limit action on business taxes to the proposed technical fix.
4. Leverage this opportunity to consider further reforms.
5. Monitor the effects of TCJA and State and City responses.

**1. Selectively decouple from federal definitions and continue to conform to others for at least one year to allow evaluation and additional reform.**

The Governor has proposed to selectively decouple from every element in Table 1 to avoid an unplanned tax increase. The proposal makes technical changes in New York law, references to federal law as it existed pre-TCJA, and allows taxpayers to itemize at the State level even if they do not do so on their federal returns.

*Assessment.* This strategy has the benefit of fully reversing the unplanned tax increase. However, it would increase taxpayers' filing efforts and the State's administrative burden. The State would have to augment its audit capacity, particularly with regard to itemized deductions for those who would now itemize only at the State level.

Decoupling from the personal exemption, enhanced child tax credit, and the SALT cap would be relatively easy to administer and would relieve New Yorkers of \$740 million of unplanned tax increases.

Decoupling is more challenging for the:

- **Standard Deduction.** Up to 1.7 million New York filers below \$100,000 AGI who currently itemize will switch to standard deductions at the federal level. Within this group, the average itemized deductions are between \$16,000 and \$18,000 annually.<sup>26</sup> Hence, they would likely prefer to itemize at the State level, creating a new administrative burden on New York State.

- **Medical Expense Deduction.** Ninety-three percent of filers and 79 percent of the amount deducted come from those with incomes less than \$150,000.<sup>27</sup> While some will forgo this deduction since they will use the new, higher federal standard deduction, others benefiting from the lower threshold will itemize. Decoupling will complicate taxpayers' decision whether or not to itemize at the State level and require the State to determine the validity of the amount since it is different from the federal threshold.
- **Miscellaneous Deductions.** Many of these deductions represent reasonable policy—deducting from income the costs of earning that income. If New York State decouples, however, it will need to audit tax files absent accompanying federal data. The major burden of continued conformity would fall on higher earners. For the 1,049 filers with more than \$10 million in annual income, the average State tax increase resulting from conformity is about \$58,000 annually. Of the 794,000 filers with less than \$150,000 in income, many will take the standard deduction. Those who do not will see average tax hikes of less than \$300.<sup>28</sup>
- **Alimony Deduction.** TCJA shifts the obligation for taxes on alimony paid from the recipient spouse to the payer spouse. The State proposes to decouple from this provision. While the State revenue impact is expected to be immaterial, differences between the federal and State tax law as to who is liable for the tax would present a challenge that will be of little value to the State.

*Recommendation.* The State should decouple from the personal exemption, enhanced child tax credit, and the SALT cap. Since conformity to the federal tax system makes filing easier for taxpayers and alleviates the State's burden of independently verifying itemized deductions, the State should not immediately decouple from the standard deduction, miscellaneous deductions, and medical expense deduction and treatment of alimony. This would result in a one-year net \$300 million State tax increase that would primarily fall on higher income New Yorkers. As a temporary measure it would be reasonable as part of a plan to cut taxes and ease the administrative burden in subsequent years.

## 2. Blunt the SALT cap to maintain competitiveness.

Reducing the negative effect of the SALT cap will require a mix of solutions that focus on high-income earners and their sources of income earned, including wage and non-wage sources.

### 2a. Create an Optional ECET.

The Governor has proposed an optional ECET. An employer who elects to participate would be subject to a tax on annual payroll expenses of more than \$40,000 per employee. This tax rate would grow from 1.5 percent in 2019 to 3 percent in 2020, and to 5 percent in 2021 and thereafter. The personal income tax system would remain intact and an employee would receive a credit against his/her own personal income tax liability roughly equivalent to the tax the employer paid related to the employee's salary.

While the proposal does not specify how a business must fund the tax expense, it is assumed that employees' gross wages or wage increases will be lower than without the ECET. This would ensure the tax is not an additional expense to the business, as the

business merely shifts the expense from employee compensation to State taxes, both federally deductible. With the ECET, the employee would have lower gross wages, but the same or higher after-tax income. Lower gross wages would reduce the employees' federal taxable income, providing relief from the SALT cap.

*Assessment.* This proposal has several benefits. The ECET:

- Could ameliorate a portion of the impact of the SALT cap for many New Yorkers. If 50 percent of New Yorkers were covered by this ECET, a rough estimate is that 14 percent of the projected \$9.6 billion SALT cap impact would be mitigated.<sup>29</sup> The ECET could help many New Yorkers since salaries and wages comprise 65 percent of New Yorkers' total income. The State estimates that someone who earns \$150,000 annually would save \$1,200 in federal taxes. However, many New Yorkers earning less than \$200,000 will take the new, higher standard deduction and will not have any SALT cap impact to remedy. But those earning more than \$1 million may get significant relief. On average, though, the benefit will be mitigated since wages comprise only 32 percent of these earners' incomes.
- May increase the eligibility for income-based public benefits for those with lower incomes.
- Can be absorbed by forgone salary increases over time rather than require salary cuts, due to the phase in.
- Is optional, allowing each business to make the right decision for its particular circumstance.

However, this proposal's design and implementation will present many challenges:

- Flattening increases in gross wages may be perceived by many employees as salary stagnation.
- The ECET could distort the labor market as similarly situated employees would have different wages depending on whether their employer elected to participate. Electing employers also would have different wage scales among states.
- Pension and retirement contributions linked to salary and social security benefits would be lowered.
- Federal employees would not receive a benefit since the State cannot tax the federal government.
- Employees commuting from other states may be disadvantaged if their home state does not recognize the New York credit as it does New York tax payments. Many states credit out of state tax payments against their own income taxes. If the New York ECET credit is not recognized, these commuters may face higher taxes in their home state.
- Collective bargaining agreements would have to be modified for covered employees, perhaps most challenging for the public sector and in situations with agreements for future increases already in place.
- Adoption may be extremely limited by the challenges of implementation, especially

those involving lower wage employees.

- Risk of federal challenge, based on the proposition that the employer is paying the employee's personal income tax and not an employer tax.

*Recommendation.* Notwithstanding the challenges of design and implementation, an optional ECET should be adopted since it would ameliorate a portion of the SALT cap impact. CBC recommends that the ECET apply to wages above a higher salary threshold than proposed and phase up to a higher rate, since the ECET presents significant challenges at the lower end of the income scale and a higher rate would remedy more of the SALT impact for covered employees.

A higher income threshold ECET would be easier to implement, more acceptable to covered employees, and cause less labor market distortion, increasing the likelihood of broader adoption. It would better target potential high earner mobility. Additional analysis should help determine the salary threshold and tax rate; however, the \$200,000 level presented in the DTF Preliminary Report should be considered. The State also should consider using its 6.65 percent marginal tax rate or higher, which would save those covered by this tier an estimated additional \$330 million more than the proposed 5 percent rate.<sup>30</sup>

Designing the ECET well, including ensuring the correct credit calculation and choosing the right rates and income levels, is a complex undertaking. The ECET was proposed as part of the Executive Budget; however it is more important that it be designed well than be adopted with the budget by April 1, 2018. The proposed October 1, 2018 employer election deadline and January 1, 2019 start allows more time for thoughtful design without delaying implementation.

New York City also should adopt an optional ECET. Analysis should be conducted to determine optimum rates and income levels, although using the State's income levels would streamline administration. The City ECET also would need to address the ramifications of not having a nonresident income tax; a decision will have to be made whether or not to levy it based on all employees or only those who are residents.

**2b. Create the opportunity for taxpayers to receive tax credits for charitable contributions for public education and health purposes.**

The Governor proposes to create a new State charitable gifts trust fund, under the joint custody of the DTF Commissioner and the New York State Comptroller, to be used for specified health and education purposes. Contributions to this fund would be deductible from State, local, and federal income taxes and taxpayers would receive a credit toward their subsequent year State income taxes equal to 85 percent of their contribution. Since contributions would be both deductible and trigger the credit, the effective credit would be between 91 percent and 94 percent.<sup>31</sup> This proposal provides relief from the SALT cap because the contribution can be deducted from income for federal tax purposes, just as the State and local tax was prior to TCJA.

The proposal also would allow localities to create charitable funds for education and health purposes. The local fund design varies slightly from the State's with the credit set at 95 percent, used to offset local property taxes, and limited in size at a locality's discretion. While not in the legislative language, State support for New York City and Yonkers to provide credits toward their local personal income taxes is included in the State's "Summary of Proposed Tax Reforms."<sup>32</sup>

*Assessment.* This proposal could:

- Meaningfully ameliorate the impact of the SALT cap. If enacted at the State and local levels all of the estimated 750,000 filers affected by the cap could take advantage of it. Unlike the ECET, its benefits are not limited to wage and salary income, which is especially important for high-income filers. For example, a filer earning \$10 million and contributing \$1.15 million to State and local health and education funds could save more than \$300,000, defraying a significant portion of the SALT cap impact.
- Be used at the discretion of the taxpayer, since charitable contributions are voluntary.<sup>33</sup>

While impactful financially, important concerns remain:

- This approach may be challenged in the courts or by federal ruling. While there is precedent for similar systems, most have been for more narrowly targeted purposes and smaller scale. The appropriateness of this approach has been questioned by the Treasury Secretary and staff, among others, indicating a substantial risk to viability.
- Uptake may be low. Some payers will be discouraged by its uncertain viability or risk.
- Many homeowners pay property taxes through a mortgage services company. The mechanism for credit and contribution would need to be worked out, and there is a risk that mortgage service companies would not be willing to participate.
- The proposed language, particularly with regard to the State charitable gifts trust fund, does not specify that the funds will be treated as part of the State budget, expended based on a legislative appropriation and in accordance with the rules that govern general fund expenditures, or may not be used for private education. The stated intent, however, is that these funds would be used for traditional governmental purposes and expended using regular governmental mechanisms.
- Localities have expressed concern they may not have the capacity to administer such a charitable fund.
- The 91 percent to 94 percent tax value of the contribution requires the taxpayer to pay an added amount to satisfy his or her State and local liability. While the federal savings will more than offset this additional State and local bill, the extra payments would provide the State and locality added funds.
- Local personal income tax revenue will be reduced when a taxpayer makes a State charitable contribution, since the contribution decreases the payer's taxable income.

*Recommendation.* The State and localities should set up charitable funds following this model, provided the legislation is modified to ensure appropriate accountability

and transparency, and that the funds are used only for public education and health purposes. The legislation should establish a mechanism to ensure funds are appropriated, expended, and reported in the appropriately and transparently. New York City also should work with the State to enable this strategy be used for its personal income tax.

## **2c. Create a business tax on pass-through entities—an Unincorporated Business Tax (UBT).**

The “Summary of Proposed Tax Reforms” indicated the State is pursuing development of a UBT. Currently the income of partnerships and other unincorporated businesses is “passed through” to the owner(s) who pay personal income taxes on that business income. Creating a UBT would allow the business to pay the State tax, which would be deductible as a business expense, and reduce the owner(s)’ State liability and federal taxable income.

*Assessment.* A UBT could have significant impact to alleviate the SALT cap, especially for high-income earners. Nineteen percent of the income of those with AGI more than \$1 million is from partnership and S Corporation income.<sup>34</sup> If all State and local taxes on partnership and S-Corp income were paid by the business and not the owner(s), a UBT could alleviate roughly 17 percent of the total SALT cap impact.<sup>35</sup>

This will not be a simple endeavor. Designing a UBT will entail defining how income is sourced, expenses are attributed, whether or not it should be optional, and how payment to partners would be audited. There also is reasonable concern that a new tax could open the door to more easily increasing the tax in the future. Finally, New York City already has a UBT, which in contrast to the State’s proposal, taxes income in addition to, and not instead of, the personal income tax. The City UBT exempts some entities from the tax and provides credits toward personal income tax based on tax liability. Overlaying a State UBT would add complexity given the different purposes and likely different base, making it harder for taxpayers to understand and more difficult to administer.

*Recommendation.* The State should pursue the UBT since it can relieve a substantial portion of the SALT cap impact and can complement the ECET. Connecticut is pursuing a UBT, which if enacted would put New York at a competitive disadvantage, especially with highly mobile, high-income individuals and partnerships. When ready, the State should publicly share the preliminary design and draft legislation as it has done with its other proposals to maximize the UBT’s potential impact without unintended consequences.

## **3. Limit action on business taxes to the proposed technical fix.**

The Governor’s proposed business income tax change is limited to a single technical adjustment, which clarifies New York’s tax law to ensure corporate taxpayers will not be allowed a deduction associated with deemed-repatriated income, since New York will not tax the income.

*Assessment and Recommendation.* The importance of conformity and ease of administration outweigh the minor unplanned tax increase caused by New York State's conforming to federal business tax definitions. The proposed technical adjustment is appropriate and should be adopted since governments should not provide deductions attributable to income that is not taxed. Furthermore, New York could lose substantial tax revenue if such a deduction were allowed.

#### **4. Leverage this opportunity to consider further reforms.**

The TCJA provides the imperative to address quickly its negative consequences. It also should provide the impetus to pursue additional reforms.

##### **4a. Consider reforming the estate tax to address New York's attractiveness to high income earners.**

Currently, New York is 1 of only 12 states that impose an estate tax, and 5 other states impose a tax only on inheritances. Considering reform of the estate tax in order to dissuade wealthy New Yorkers from leaving the Empire State for lower taxed locales is important given the impact of the SALT cap.

New York State imposes a tax on the estates of deceased State residents and on deceased nonresident's real and tangible personal property in New York State. New York's definition of a taxable estate is based on federal definitions, with certain New York modifications. New York's estate tax imposes a maximum rate of 16 percent and only applies to taxable estates of more than \$5.25 million. The estate tax raises approximately \$1 billion per year, ranging from a 10-year minimum of \$865 million in fiscal year 2010 to a maximum of \$1.5 billion in fiscal year 2016.

Estate tax reform could be accomplished by reducing the rates, increasing the exemption, fixing the "cliff" that results in a greater than 100 percent marginal rate on certain estates, or repealing the tax. TCJA's increase in the federal exemption will reduce federal revenues by \$8.1 billion, or 31 percent of federal estate tax revenues.<sup>36</sup> Assuming that the distribution of estates in New York mirrors the federal distribution, adopting the revised federal exemption and treatment of married couples in New York would reduce State revenues by approximately \$310 million.

##### **4b. Control spending to reduce the need for high State and local taxes.**

Both New York State and New York City are high spending and high taxing jurisdictions. In many ways this reflects local preference supported by many residents. However, it is also a function of spending growth without offsetting increases in productivity and spending on unproductive programs.

The State has taken several steps to decrease spending and taxes. On January 1, 2020 the State's top personal income tax rate is scheduled to fall from 8.82 percent to 6.85 percent for married couples with incomes exceeding \$2.2 million. The surcharge should be allowed to expire as planned, supported by accompanying spending reductions.

Governor Cuomo implemented a number of cost-saving programs early in his tenure, including the Global Medicaid Cap, a new pension tier, and a negotiated increase in employee health insurance contributions. There are still many areas for additional spending discipline, and recent State spending has grown more than inflation.<sup>37</sup>

Education spending has grown faster than personal income in every year since 2012, despite a cap on growth. New York spent \$21,206 per pupil compared to a national average of \$11,392 in school year 2014-2015.<sup>38</sup> Better targeting spending to the highest needs districts would contain costs while ensuring that all students have access to a sound basic education.<sup>39</sup> The State wastes \$1.2 billion annually on property tax rebates and allocates \$4 billion annually on economic development spending with a sparse record of results.<sup>40</sup> Curtailing spending in these areas would reduce pressure to increase taxes and lessen the tax differential with other states.

Restraining New York City's spending also would reduce the pressure to generate high local taxes. City funded spending, adjusted for prepayments, debt defeasance, and the surplus roll, has grown by 44 percent from 2008 to 2017, or 4.2 percent per year on average.<sup>41</sup> The City could reduce spending or slow spending growth in several areas including personnel, employee health insurance, and greater government efficiency. City headcount has grown 8.4 percent, from 297,349 in fiscal year 2014 to 322,407 in fiscal year 2017 and is projected to reach 330,957 this year.<sup>42</sup> New positions created for initiatives such as pre-K, neighborhood policing, and social services have not been funded with offsetting efficiencies. Total spending on wages and salaries has grown 21 percent over the period, as average compensation per employee increased.<sup>43</sup>

Unlike most private employers and New York State, the City pays the full cost of health insurance premiums for municipal employees and retirees. The City's efforts in partnership with the Municipal Labor Council generated savings in recent years. However, premium sharing and other changes should be pursued to bend the cost curve; annual growth is projected at 8.4 percent each year through fiscal year 2022.<sup>44</sup> In addition, the City should bolster efforts to generate savings from increased productivity and efficiencies. Just 14 percent of the \$3.3 billion Preliminary Fiscal Year 2019 Citywide Savings Program comes from recurring efficiency savings.<sup>45</sup>

#### **4c. Consider broader reforms to simplify the tax system.**

Federal tax reform is an opportunity for State policymakers to rethink New York's tax system, as was true after the 1986 federal changes. After 1986 states around the country, including New York, overestimated the "windfall" effect of that law and endured years of fiscal turmoil. An important and still-relevant lesson is that responding in haste to sweeping federal changes is dangerous.

New York's leaders will be wise to proceed in phases—taking necessary targeted steps now to avert the worst damage, while stepping back to examine and debate how best to structure New York's finances in the new federal environment. The State and the City should consider if there are additional broad reforms to that make the tax system

more fair, efficient, and better for the economy.

While it is too early to generate a comprehensive list of what should be considered, discussion should:

- Identify opportunities to broaden tax bases and lower rates;
- Consider if there are benefits to shifting from reliance on the income tax, and/or whether a flatter rate structure with progressivity provided by other means, including credits, would improve competitiveness and fairness;
- Identify opportunities to increase conformity with the federal system; and
- Reform the New York City property tax to improve fairness.

**5. Monitor the effects of TCJA and State and City responses.**

TCJA and the State and City responses will have predicted and unforeseen impacts that could be significant and should not be discounted. Financial and legal interpretation will have significant effects and behavioral and economic impacts will play out over time. The State and the City should monitor these effects and adjust policy as needed to promote competitiveness, fairness, and good public fiscal policy. Of highest importance is monitoring how the impact of the SALT cap affects high earner mobility, the attractiveness of New York as a place for all earners to live and for businesses to originate and grow, and the implementation of an ECET.



## CONCLUSION

State and City leaders should take decisive action to maintain competitiveness and protect New Yorkers. These recommendations include steps needed to address the problems created by the TCJA and to signal that New York is a desirable place to live, work, and run a business. The recommendations are, however, less than perfect. Given the challenges presented by TCJA, New York should not let the perfect be the enemy of the practical and urgent. The State and localities should implement responses, monitor impacts, and make changes as needed.

These policies are necessitated by challenging circumstances. Some may not be legally viable, may not have broad uptake, and may need to change over time as federal policy may change. To the extent that responses to the challenges presented by TCJA are not viable or do not get significant uptake, the imperative only increases for the State and its localities to control spending, further reform the tax system, and implement other measures to increase New York's competitiveness.



## APPENDIX 1: CBC SPECIAL COMMITTEE ON FEDERAL TAX CHANGES

- Ingrid Gould Ellen, Ph.D., Paulette Goddard Professor of Urban Policy and Planning, Director for Furman Center for Real Estate and Urban Policy, NYU
- Peter Hein, CBC Trustee; Of Counsel, Wachtell, Lipton, Rosen & Katz
- Kent Hiteshew, CBC Trustee; Strategic Advisor, Ernst & Young LLP; Senior Fellow, Marron Institute of Urban Management, NYU
- Eugene Keilin, CBC Trustee; Principal, Keilin & Co. LLC
- Marvin Markus, Managing Director, Goldman Sachs
- James Rubin, Chief Executive Officer, Meridiam, North America; Former NYS Director of Operations
- Andrew Sidamon-Eristoff, Former Commissioner, NYS Department of Taxation and Finance and NYC Department of Finance; Former NJ State Treasurer
- Edward Skyler, CBC Chair; Executive Vice President, Global Public Affairs, Citi; Former NYC Deputy Mayor
- William C. Thompson, Jr., CBC Trustee; Senior Managing Partner, Siebert Cisneros Shank & Co. L.L.C.; Former NYC Comptroller
- Alair Townsend, CBC Trustee; Former Director, NYC Office of Management and Budget
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- Andrew Rein, Committee Director; Principal, Health Transformation Strategies
- Dan Boyd, Principal, Boyd Research
- Thad Calabrese, Assistant Professor, New York University
- David Friedfel, Director of State Studies, CBC



## APPENDIX 2: IMPACT OF THE SALT CAP ON REPRESENTATIVE TAXPAYERS

		NYC			Total Tax Difference with Florida		
AGI	Payer Description <sup>a</sup>	Federal Tax Liability			2017	2018	Change
		2017	2018	Change			
<b>\$100,000</b>	Single, 0 kids, Renter	\$32,400	\$30,710	(\$1,690)	\$8,174	\$9,065	\$891
<b>\$100,000</b>	Married, 4 kids, Renter	\$19,662	\$16,039	(\$3,623)	\$7,767	\$7,767	\$0
<b>\$350,000</b>	Single, 0 kids, Renter	\$120,192	\$120,361	\$169	\$31,644	\$33,811	\$2,167
<b>\$350,000</b>	Married, 2 kids, Owner	\$98,539	\$85,279	(\$13,260)	\$28,409	\$28,652	\$243
<b>\$1,000,000</b>	Married, 2 kids, Owner	\$338,588	\$342,551	\$3,963	\$49,868	\$82,563	\$32,695
<b>\$10,000,000</b>	Married, 2 kids, Owner	\$3,810,419	\$3,981,251	\$170,832	\$645,496	\$1,068,701	\$423,205
<b>\$10,000,000</b>	Married, 2 kids, Owner, Nonwage	\$3,146,007	\$3,413,159	\$267,152	\$630,913	\$1,068,586	\$437,673
<b>\$10,000,000</b>	Married, 2 kids, Owner, Nonwage (20% deductible)	\$3,146,007	\$2,913,044	(\$232,963)	\$630,913	\$1,068,585	\$437,672
		OUTSIDE NYC <sup>b</sup>					
<b>\$1,000,000</b>	Married, 2 kids, Owner	\$341,523	\$342,551	\$1,028	\$45,391	\$75,151	\$29,760
<b>\$10,000,000</b>	Married, 2 kids, Owner	\$3,889,185	\$3,981,251	\$92,066	\$525,356	\$869,795	\$344,439
<b>\$10,000,000</b>	Married, 2 kids, Owner, Nonwage	\$3,229,224	\$3,413,159	\$183,935	\$515,224	\$869,680	\$354,456
<b>\$10,000,000</b>	Married, 2 kids, Owner, Nonwage (20% deductible)	\$3,229,224	\$2,913,044	(\$316,180)	\$515,224	\$869,679	\$354,455

<sup>a</sup> Indicates: filer status, either single or married filing jointly; child tax credits, either none or 2 children under 13; homeownership status, either renter or owner; and income type, either wage (signified by no entry), nonwage, or nonwage from an activity qualifying for the 20 percent pass-through deduction.

<sup>b</sup> Outside NYC assumes NYC suburbs.

Source: CBC staff analysis assuming representative taxpayer characteristics using New York State Department of Taxation and Finance, *Instructions for Form IT-201* (accessed March 9, 2018), pp. 57-60, 69; and Tax Policy Center "Tax Proposal Calculator" (accessed March 7, 2018).



## ENDNOTES

- 1 H.R.1 - An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, P.L. 115-97.
- 2 Joint Committee on Taxation, Estimated Budget Effects of the Conference Agreement for H.R. 1, the “Tax Cuts and Jobs Act, JCX-67-17 (December 18, 2017), [www.jct.gov/publications.html?func=startdown&id=5053](http://www.jct.gov/publications.html?func=startdown&id=5053).
- 3 This is a partial list; specific elements noted are a portion of changes in those areas.
- 4 This is a partial list; specific elements noted are a portion of changes in those areas.
- 5 Under a worldwide system, all income, no matter where earned, is taxed in the U.S. when distributed or repatriated to the U.S., with credits for taxes paid to other countries. Under a territorial system, only U.S. domestic economic activity is taxed. As part of the transition to this new system, certain previously untaxed foreign income will be deemed to be repatriated under “Subpart F” of the Internal Revenue Code and will be subject to federal tax at reduced rates, generating a one-time federal revenue boost that partially offsets the rate reduction. In addition, the new federal law includes several anti-abuse mechanisms in an effort to limit unintended loopholes.
- 6 A corporation is a form of business that generally shields its owners or investors from liability, among other characteristics. C corporations, named after Subchapter C of the Internal Revenue Code, generally are taxed on their income under the federal corporate income tax. Owners of a C Corporation are taxed under the personal income tax on dividends paid to them by the corporation, but not on income retained in the corporation. In contrast, S corporations (named after Subchapter S of the IRC), Limited Liability Companies (LLCs), partnerships and sole proprietorships are “pass-through” entities. They generally do not pay corporate income taxes; instead, their income is treated as “passed through” to the owners and subject to personal income tax, regardless of whether the income is paid to the owners or retained in the entity. Most states treat C corporations and S corporations and their owners similarly to the federal treatment, but there is considerable variation.
- 7 New York State Department of Taxation and Finance, Preliminary Report on the Federal Tax Cuts and Jobs Act, (revised, January 23, 2018) [https://www.tax.ny.gov/pdf/stats/stat\\_pit/pit/preliminary-report-tcja-2017.pdf](https://www.tax.ny.gov/pdf/stats/stat_pit/pit/preliminary-report-tcja-2017.pdf).
- 8 CBC staff analysis of data from Internal Revenue Service, Statistics of Income Division, “SOI Tax States – Historic Table 2 ”Individual Master File, 15in33ny (accessed March 7, 2018), <https://www.irs.gov/statistics/soi-tax-stats-historic-table-2>.
- 9 Those subject to the AMT are not affected by the SALT cap. TCJA’s AMT modifications change who is covered, increasing the challenge of using prior years’ data for analysis.
- 10 CBC staff analysis of data from Internal Revenue Service, Statistics of Income Division, “SOI Tax States – Historic Table 2”Individual Master File, 15in33ny (accessed March 7, 2018), <https://www.irs.gov/statistics/soi-tax-stats-historic-table-2>.

[gov/statistics/soi-tax-stats-historic-table-2](#). The increase in New York taxpayer federal liability was estimated using the 2015 Statistics of Income Division income deciles. Taxpayer deciles less than \$100,000 in annual AGI have an average SALT deduction less than \$10,000 and are assumed unaffected on average by the SALT cap. For the remaining deciles, the average SALT paid was capped at \$10,000 annually, and the difference in the average loss multiplied by the number of itemizers becomes the estimate of total SALT lost from the TCJA. The marginal federal tax rates are applied to these losses to estimate increased federal liabilities. Because taxpayers subject to AMT were included in this initial analysis, we then excluded from this loss estimate the proportion of taxpayers previously subject to AMT and, therefore, not losing SALT benefits under TCJA.

- 11 More than 82 percent for taxpayers between \$200,000 and \$500,000, nearly 63 percent for those between \$500,000 and \$1 million, and more than 22 percent for those earning more than \$1 million had already lost the SALT deduction because they were subject to the AMT.
- 12 Testimony of Michael Hyman, First Deputy Commissioner, New York City Department of Finance, before the New York City Council Committee on Finance, Oversight Hearing: Impact of the Federal Tax Law on New York City (February 26, 2018), <http://www1.nyc.gov/assets/finance/downloads/pdf/18pdf/impact-of-federal-tax-law-on-nyc.pdf>.
- 13 Testimony of Preston Niblack, Deputy Comptroller for Budget, Office of the New York City Comptroller, before the New York City Council Committee on Finance, Oversight Hearing: Impact of the Federal Tax Law on New York City (February 26, 2018), <https://comptroller.nyc.gov/newsroom/testimonies/testimony-of-new-york-city-deputy-comptroller-for-budget-preston-niblack-the-impact-of-the-federal-tax-law-on-new-york-city/>.
- 14 New York State Department of Taxation and Finance, “Analysis of 2014 Personal Income Tax Returns” (accessed March 7, 2018), [https://www.tax.ny.gov/research/stats/stat\\_pit/personal\\_income\\_tax\\_returns/analysis\\_of\\_2014\\_personal\\_income\\_tax\\_returns.htm](https://www.tax.ny.gov/research/stats/stat_pit/personal_income_tax_returns/analysis_of_2014_personal_income_tax_returns.htm).
- 15 CBC staff analysis of data from New York State Department of Taxation and Finance Instructions for Form IT-201 (accessed March 9, 2018), pp. 57-60, 69, [https://www.tax.ny.gov/pdf/current\\_forms/it/it201i.pdf](https://www.tax.ny.gov/pdf/current_forms/it/it201i.pdf); and Tax Policy Center, “Tax Proposal Calculator” (accessed March 7, 2018), <http://tpc-tax-calculator.urban.org/>.
- 16 New York State Department of Taxation and Finance, “Analysis of 2014 Personal Income Tax Returns” (accessed March 7, 2018), [https://www.tax.ny.gov/research/stats/stat\\_pit/personal\\_income\\_tax\\_returns/analysis\\_of\\_2014\\_personal\\_income\\_tax\\_returns.htm](https://www.tax.ny.gov/research/stats/stat_pit/personal_income_tax_returns/analysis_of_2014_personal_income_tax_returns.htm).
- 17 New York City Independent Budget Office, “Financial History: New York City Residents’ Income and Tax Liability” (accessed March 7, 2018), <http://www.ibo.nyc.ny.us/fiscalhistory.html>.
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# Practical Policy in Challenging Circumstances:

How New York State and New York City Should  
Respond to the Tax Cuts and Jobs Act

**Report** ■ **March 2018**

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