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NEW YORK STATE

TAX REFORM AND FAIRNESS COMMISSION

FINAL REPORT

NOVEMBER 2013

GOVERNOR ANDREW CUOMO'S TAX REFORM AND FAIRNESS COMMISSION

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The Honorable Andrew M. Cuomo
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Dear Governor Cuomo:

On behalf of the New York State Tax Reform and Fairness Commission, it is our pleasure to submit our final report. Your charge to us was to undertake a broad review of the State's complex tax code, to find ways to make it simpler and fairer and to help reduce the tax burden faced by New Yorkers and businesses. This report summarizes the Commission's recommendations to address your concerns within the constraint that they have a revenue neutral impact on the State's budget.

Our report is directed at reforming several parts of the State's tax code that contribute to its complexity, its inequitable treatment of individual and business taxpayers and its negative impact on State revenues. For example, the State's tax code is riddled with exemptions and tax expenditures favoring few taxpayers. There are 150 exemptions to the Sales/Use Tax, and more than $2 billion in tax incentives are provided to businesses every year. Personal income taxpayers have to make up to 80 modifications to their federal adjusted gross income (AGI) to get to State AGI – the starting point for calculating NYS tax liability. Simplifying the tax code would provide relief to millions of taxpayers.

The Commission does not expect every recommendation to be adopted. It, therefore, provides a menu of options within the context of State revenue neutrality. It does hope, however, that its conclusions and the extensive, documented studies and analysis will be used to reform and to simplify the tax code over a period of time.

Clearly, the tax code of a government reflects many judgments by political leaders balancing the interests of often competing constituencies. Good tax policy including a more equitable tax code would limit exemptions and tax expenditures for the few and lower taxes for all taxpayers. The Commission hopes it has contributed to the thinking of how to achieve such a result.

On behalf of all the Commissioners, we thank Robert D. Plattner, Deputy Commissioner of Tax Policy of the New York State Department of Taxation and Finance, who headed our staff effort and the members of his staff who prepared numerous reports for the Commission. We also thank officials of the City of New York for their participation in the Commission's deliberations.

We express our gratitude to Peter G. Peterson for his support of our business tax credit analysis. We are grateful to the many professionals, citizens and businesses of the State of New York who offered their suggestions for reforming the State's tax code. We thank Richard I. Beattie for his counsel and Diane M. Coffey, Andrew G. Sugrue and Judy E. Vance of Peter J. Solomon Company for their help throughout the past year. We thank Dr. Marilyn Marks Rubin for her technical expertise.

Our special appreciation goes to members of the Commission whose input was so valuable in our efforts to improve tax policy in New York State.

Yours truly,

Peter J. Solomon

H. Carl McCall

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INTRODUCTION

Governor Andrew Cuomo established the New York State Tax Reform and Fairness Commission in December 2012 to conduct a comprehensive and objective review of the State's tax structure, including its corporate, sales, estate and personal income taxes. The Commission was charged with developing revenue neutral policy options to modernize the current tax system with the goals of increasing its simplicity, fairness, economic competitiveness and affordability. The Governor asked the Commission to complete its work and present its report to him by mid-November of this year.

The Commission has responded to the Governor's charge with a report that offers options for significant changes to the State's tax structure and administration. The Commission's proposals were informed by analyses undertaken by the New York State Department of Taxation and Finance staff and by public finance experts. The Commission also engaged in extensive outreach, meeting with a broad cross-section of interest groups—business associations, labor, regional organizations, public interest groups, the State CPA Society and others. Conversations with these groups provided invaluable input that complemented the Commission's extensive research.

Since taking office in 2011, Governor Andrew Cuomo has taken significant steps to improve New York's business climate and to make taxes more affordable for average New Yorkers. These include significant reforms to the State's Personal Income Tax and Real Property Tax.

- Significant reforms were undertaken in the State's Personal Income Tax to increase its overall progressivity by lowering rates for the vast majority of New York taxpayers. In 2006, more than 3.8 million taxpayers, nearly 60 percent, paid the top rate of 6.85 percent. Under the Governor's reforms, only 323,000 taxpayers (4.8%) paid 6.85 percent or more, and 41,000 (0.6%) paid 8.82 percent. All New Yorkers paid at a lower income tax rate than they did in 2010, before Governor Cuomo took office;
- Governor Cuomo has taken major steps to reduce the high burden of the Real Property Tax by introducing the State's first real property tax cap, which was enacted in 2011. The cap limits increases in school and local real property taxes to two percent a year, or the rate of inflation, whichever is less, with narrow limited exemptions;
- Data indicate that the real property tax cap is already having an impact. Since enactment, the cap succeeded in keeping growth in local real property taxes to just 2 percent, 40 percent lower than the average rate of growth in the previous decade; and
- Over the two-year period that the property tax cap has been in place, an average of 95 percent of school districts and 80 percent of county and other local government jurisdictions have stayed within the cap.

Despite these steps, it is clear that more is left to do. New York's taxes are still too high and its tax code too complex, placing undue burdens on individuals and businesses. What follows are the major findings of the Commission and a series of options to continue the significant progress of reforming the tax system that the Governor has begun.

MAJOR FINDINGS

Tax Burden:

- New York is regarded as a "high tax" state. In State fiscal year 2012-13, the State and local governments levied approximately $146 billion in taxes.[1] State taxes comprised just under $64 billion, or about 44 percent of total State and local tax collections. Local taxes made up the remaining 56 percent, the majority of which came from the real property tax ($49 billion).
- New York's heavy reliance on local taxes (56%) is the fourth highest among all states and New York's high property taxes are a major contributor to New York's poor rankings in comparisons that measure combined State and local tax burdens.

Tax Administration:

- Because of the complexity of the State's tax laws, compliance for taxpayers is often unduly burdensome. While simplification of the tax laws is the best way to ease compliance, there are nonetheless many opportunities to simplify the administration of the current system.
- Filing can be made easier in any number of ways. For example, the State could reduce the frequency of filing for small businesses and the timing of certain filings could be synchronized to ease compliance.
- Other opportunities exist for improved coordination between the State and New York City, in particular with respect to corporate tax audits, but also regarding other taxes including the sales tax on hotel occupancy and the cigarette tax.

Sales Tax:

- Owing to shifts in consumer spending, technological advances and a proliferation of exemptions from the tax, sales tax revenue has grown much more slowly than New York's economy. While sales tax collections are increasing over time, these increases mask underlying weaknesses in the tax that have diminished its role as a revenue producer for the State.
- New York State's narrow sales tax base in part reflects an attempt to reduce the regressivity of the tax. New York exempts many household necessities such as food, clothing and health-related products to shield low-income households from burdensome taxation. Exempting certain necessities, however, is a highly inefficient way to protect lower income households. Of the $3.2 billion the State annually forgoes in revenues as a result of these tax exemptions, only $900 million — less than one-third — benefits households earning under $50,000, while households earning in excess of $100,000 reap $1 billion in tax savings.
- New York's sales tax is unduly complex. This complexity makes voluntary compliance more difficult, increases the cost of doing business in the State, creates financial risk for vendors who "get it wrong" and adds to the government's tax administration costs.

[1] Not all of the taxes that New York State and its localities levy are paid by New York residents. For example, approximately 15 percent of the personal income tax is paid by nonresidents who live outside the State but who have income from New York sources.

- Certain exemptions from the sales tax create an uneven playing field among competing businesses.

Corporate Taxes:

- The State's basic corporate franchise tax structure is badly outdated, unduly complex and vulnerable to aggressive tax avoidance techniques. It taxes similarly situated taxpayers differently, and in some instances creates disincentives to increasing a corporation's activities in New York.
- One glaring example is that the current tax structure has not been revised to account for the dramatic changes in the financial services sector wrought by federal law enacted almost fifteen years ago (Gramm-Leach-Bliley Act (GLBA)). New York continues to tax banks and other financial corporations under different articles of the Tax Law, based on "transitional provisions" that have preserved the tax status of these corporations as of the time the GLBA became law.
- The current system violates the basic tax policy principles of fairness and efficiency, increases compliance and administration costs and results in a volatile revenue base. More than 20 percent of corporate taxes are collected through the audit process, a telling statistic supporting the need for reform.

Business Tax Incentive Credits:

- The tax code has seen a dramatic increase in the number of business tax incentive credits, often designed to promote job creation, particularly in areas of the State where growth has been stagnant. Despite good intentions, these credits may not result in a good return on investment for the State. They are not subject to the annual appropriation process, and more efforts are needed to measure their effectiveness.

Estate and Gift Tax:

- New York's estate tax, currently based on federal law as it existed in 1998, is outdated.
- The federal exemption level for both estate and gift taxes is now $5.25 million. In contrast, the State's estate tax exemption level is only $1 million, while the State imposes no gift tax at all.
- The current exemption threshold of $1 million has been criticized as too low given significant increases in the value of assets. In addition, there are concerns that it may serve as a factor in taxpayer migration from New York to other states (e.g. Florida) that do not impose any estate tax.
- Under the new federal scheme, gift giving has increased substantially, which will result in smaller estates and an erosion of the State's estate tax revenues.

Personal Income Tax (PIT):

- The PIT is the single largest source of State revenues, $40 billion, which represents over 60 percent of all State revenues collected by the Department of Taxation and Finance. This figure is higher than the percentage in all but a few other states, indicating New York's heavy reliance on the PIT as a source of revenues.
- A positive feature of the State's income tax is that it is quite progressive. This progressivity is a consequence of several features of the tax, including its graduated rate structure. Other features of the income tax that increase progressivity include a high standard deduction, limits on the availability of itemized deductions for certain high-income taxpayers and refundable credits for low-income

taxpayers. New York's heavy reliance on its progressive income tax results in an overall tax system that is more progressive than all but a handful of states.

Real Property Tax Administration:

- New York's system of property tax administration has been ranked among the lowest in the 50 states.[2]
- New York does not require a single valuation standard, or set of standards, that applies to all properties, and does not require that assessments be updated periodically.
- With nearly 1,000 assessing units, New York has many more than most states of comparable size, and in some instances two or more different assessing units establish different values for a single parcel of property.
- These administrative features result in a lack of fairness and transparency in the administration of the tax and represent a compliance burden for businesses.

[2] Council on State Taxation, The Best and Worst of Property Tax Administration, May 2011.

OPTIONS FOR REFORM

The Commission has provided five reform packages that are self-contained. Measures that raise revenue are coupled with equal amounts of tax relief.

The Commission suggests that the State:

- Modernize the sales tax while funding low- and middle-income tax relief and overall real property tax relief.
- Modify the estate tax and other wealth-related taxes to relieve the burden on middle class families and address concerns regarding the impact of the estate tax on the migration of wealthy New Yorkers to other states.
- Reform the State's corporate and bank franchise taxes to better reflect how businesses operate in a 21st century economy and improve business tax incentives so they achieve their economic and social goals at an appropriate cost to the State.
- Update the State's outdated system of local real property tax administration.
- Simplify the administration of taxes to ease compliance for businesses and individuals in New York.

The fiscal impacts of the Commission's revenue neutral options, detailed in this report, are summarized in the following table:

Options For Reform – Fiscal Impacts	Amount (in millions)
Sales Tax Reform	
Option 1a	
Repeal Sales Tax Exemption for Clothing and Footwear under $110	$800
Provide Low- and Middle-Income Taxpayer Relief	($400)
Provide Real Property Tax Relief	($400)
Option 1b	
Modernize the Sales Tax by Imposing Tax on All Comparable Products Equally	
✓ Expand the Base to Include Digital Products	$35
✓ Restore Competitive Balance and Remove Special Exemptions	$110
Option 1c	
Additions to the Sales Tax Base	$817
Option 1d	
Establish a Tax Reduction Reserve Fund to Finance Future Tax Relief	
✓ Redirect Revenue from Option 1b; or	($145)
✓ Redirect Revenue from Option 1b and Option 1c	($962)
Estate and Gift Tax Reform	
Increase Exemption from $1 Million to $3 Million	($300)
Repeal Generation-Skipping Tax	0
Reinstate the Gift Tax	$150
Close Resident Trust Loophole	$150
Corporate Tax Reform and Phase Out of 18-A Surcharge	
Modernize the State's Corporate and Banking Franchise Taxes	($130)
Reform and Repeal Certain Business Tax Incentives	
✓ Reform the Investment Tax Credit (ITC)	$65
✓ Repeal the Financial Services ITC	$30
✓ Brownfield Tax Credit Reforms	$35
✓ Reduce the Empire State Film Production Tax Credit Allocation	$50
Simplify and Streamline the Corporate Audit Process	$150
Accelerate Phase-out of 18-A Surcharge	($200)

The tax simplification options that would result in modest fiscal impacts are summarized in the following table:[3]

Tax Simplification – Fiscal Impacts	Amount (in millions)
Repeal the Organization Tax (§180) and License Fees (§181.1)	($9)
Eliminate Household Credit Offset	($30)
Adopt Nonresident 14-day *De Minimis* Rule	($50)
Align LLC/Partnership Filing Fee Dates with PIT	($65)[4]
Merge Motor Fuel Tax and Petroleum Business Tax	($47)

[3] The Commission believes that these costs are sufficiently modest to be manageable through the normal budget-making process or by redirecting revenue generated by other proposals put forward in this report.
[4] One-time revenue loss

PACKAGE #1
Sales Tax Reform

Background

The New York State sales and use tax dates back to 1965 and was largely based on the local sales taxes in effect at that time. Unless specifically exempted, all purchases of tangible personal property are subject to the tax. Services are not taxable unless specifically enumerated. Many goods and services commonly taxed in other states are exempt from sales tax in New York. The sales tax law is filled with outdated definitions and has not kept pace with the evolution of the digital marketplace.

The sales tax is a regressive tax — low-income taxpayers pay a greater percentage of their income in sales tax than higher income taxpayers. The Commission estimated the burden of the State and local sales tax on households at different income levels. The results, presented in Table 1, show that a typical household in New York City with income of $50,000 pays approximately $1,583 annually in sales taxes, or about three percent of its income. Households in New York City with incomes of $1 million pay just over one percent of their income in sales tax.

Businesses are affected by sales tax in two ways. Sellers of taxable goods and services must collect the tax from their customers and remit what they collect to the State. Businesses also pay sales tax on their purchases of taxable goods and services. The Department of Taxation and Finance estimates that 37 percent of sales tax is paid by businesses. Sales taxes are also paid by nonresidents who make purchases in New York, thereby “exporting” a share of the overall sales tax burden to nonresidents.

Table 1. State and Local Sales Tax by Income for a Typical Household[5]

	New York City		Outside NYC	
Income	State and Local Sales Tax	Tax as a % of Income	State and Local Sales Tax	Tax as a % of Income
$ 15,000	$ 840	5.60%	$ 566	3.77%
$ 25,000	$ 977	3.91%	$ 653	2.61%
$ 50,000	$ 1,583	3.17%	$ 1,090	2.18%
$ 75,000	$ 2,109	2.81%	$ 1,442	1.92%
$ 100,000	$ 2,457	2.46%	$ 1,666	1.67%
$ 250,000	$ 3,919	1.57%	$ 2,634	1.05%
$ 500,000	$ 6,591	1.32%	$ 4,430	0.89%
$ 1,000,000	$ 11,085	1.11%	$ 7,451	0.75%
$ 2,000,000	$ 18,642	0.93%	$ 12,530	0.63%
$ 5,000,000	$ 39,190	0.78%	$ 26,342	0.53%

The tax law contains over 150 separate exemptions from the sales tax, many of which are intended to alleviate the regressivity of the tax, such as the exemptions for food, residential energy and clothing. Yet only an estimated 28 percent of the benefit from sales tax exemptions for household necessities such as food and clothing goes to families with annual incomes below $50,000, while a third of the benefit accrues to households with annual incomes above $100,000. The Commission therefore concludes that exemptions are

[5] For this analysis, the Commission examined the incidence of the sales tax on a two-parent family with two children.

inefficient mechanisms for delivering tax relief to low-income New Yorkers. In its place, the Commission has identified a series of options listed below that could eliminate inefficient exemptions, align the sales tax base with a 21st Century economy and target tax relief to those in need.

- Repeal the sales tax exemption on items of clothing and footwear costing less than $110;
- Modernize the sales tax to treat all comparable products equally regardless of the manner or medium in which they are sold; and
- Add additional services to the sales tax base to create greater uniformity between the State and local tax bases.

The Commission suggests that consideration be given to using the revenues generated from these reforms to provide low-income tax relief to compensate for increases in the sales tax burden and to provide real property tax relief. The Commission recognizes that a broadened sales tax base will allow for greater predictability and stability of revenue collections for the State, increased revenues for local governments, and a larger share of the tax burden being shifted to nonresidents.

Option 1a
Repeal the Sales Tax Exemption for Items of Clothing and Footwear Costing Less Than $110:

Currently, clothing and footwear costing less than $110 per item are exempt from the State sales tax. Local governments have the option to exempt clothing from their portion of the sales tax; the City of New York and eight out of fifty-seven counties have chosen to do so.

Options for Low- and Middle-Income Taxpayer Relief and Real Property Tax Relief:

Repealing the clothing and footwear exemption would provide $800 million in additional State revenue that could be used to finance an equal combination of 1) targeted tax relief to "make whole" low- and middle-income taxpayers impacted by sales tax base broadening,[6] and 2) provide broad-based real property tax relief.

Several alternatives are available to provide tax relief to low- and middle-income families such as enhancing the State's Household Credit or Earned Income Tax Credit (EITC), or creating a stand-alone sales tax relief credit. The Commission concludes that an expanded Household Credit would most effectively address the impact of sales tax base broadening on low- and middle-income taxpayers.

Enhance the Household Credit:

An enhanced Household Credit would be available to all taxpayers below a certain income who file an income tax return. The current credit varies by income and family size and could be restructured to be refundable in order to more effectively alleviate the regressivity of the sales tax.

Enhance the Earned Income Tax Credit:

Part of the original rationale for the enactment of the federal EITC was to provide relief from federal payroll taxes to low-income families. The State could enhance the State EITC, which is currently equal to 30 percent

[6] Depending on how the tax relief was structured, the credit available to many low- and middle-income households would relieve a portion of their existing sales tax burden as well.

of the federal credit, to target relief to working families. The one disadvantage of the EITC is that it applies solely to working families and would not benefit non-working families, such as retired senior citizens, who do not qualify for the EITC but still pay sales tax.

Provide Stand-Alone Sales Tax Relief Credit:

A new credit could be added to the personal income tax to meet the objective of providing sales tax relief to low- and middle-income families.

Provide Real Property Tax Relief:

Options for real property tax relief include:

- Adding a new income tax credit that is targeted to those who bear the largest property tax burdens relative to their income; or
- Other forms of real property tax relief.

Given the significant burden borne by businesses, consideration should also be given to targeting real property tax relief to businesses that bear a large burden of the property tax.

Option 1b
Expand the Base to Include Digital Products:

An increasing number of goods traditionally sold and taxed as tangible personal property are being replaced by digital products that are currently not subject to State and local sales tax. Examples include:

- iTunes and music streaming services replacing CDs;
- eBooks replacing hardcopy and paperback books; and
- video-on-demand services through cable providers or online replacing DVDs.

The State currently forgoes $35 million per year by not taxing digital products. Revenue losses will increase as technological change accelerates. Twenty-three states now tax digital products to protect against the erosion of their tax bases and to level the playing field between online retailers and Main Street businesses.

Restore Competitive Balance and Remove Special Exemptions:

Several industries enjoy special tax advantages that may have outlived their original purpose.

Energy Service Companies:

In 2000, New York deregulated its energy markets to encourage "retail choice." In the deregulated market, the Legislature exempted charges for the delivery of energy purchased from an Energy Service Company (ESCOs) from the sales tax. In contrast, when electricity is purchased from a regulated utility, the entire delivery charge is subject to tax.

Energy service companies, however, are now well-established and the tax advantage that they have received is no longer necessary. The Legislature has previously repealed the exemption from the New York City sales tax base. If the exemption were eliminated statewide, it would generate an additional $60 million in State revenue and $35 million in incremental revenues for local governments.

Other:

Other examples of special sales tax exemptions that could be eliminated include:

- Self-storage facilities ($20 million increase in State revenue);
- Sales of otherwise taxable products through coin-operated vending machines ($20 million increase in State revenue); and
- Coin-operated car washes ($10 million increase in State revenue).

The policy rationale for exempting the above goods and services is unclear and in some cases outdated.

- Storage services are generally subject to tax, but the rental of a unit in a self-storage facility is not;
- Vending machine sales of certain food and drink are not subject to sales tax but are taxable if purchased in a convenience or grocery store; and
- Exemptions for coin-operated car washes only apply to cash purchases. Payments by credit card are subject to taxation.

Option 1c
Align the Sales Tax Base with Current Consumption Trends and Increase Uniformity Between the State and Local Tax Bases:

There are a number of actions available that would align the sales tax base more closely with changes in consumer consumption patterns and simplify the administration of the sales tax by conforming the State and local sales tax bases. Many of these options, however, would be controversial because they impose the sales tax on goods and services that have been exempt since the adoption of the tax. The Commission is, therefore, not proposing their inclusion in the tax base. The Commission suggests that there be further discussion of the advantages and disadvantages of including them. Listing these exemptions provides a fuller picture of goods and services that are currently taxed by some of the State's local governments and by other states. Many of these exemptions also make the sales tax more complex and burdensome for vendors.

These options include:

Additions to the Sales Tax Base	State Revenue ($ millions)
Eliminate Gas Cap at $2 per Gallon	371
Personal Services	117
Dry Cleaning and Laundering	85
Nonprescription Drugs	65
Broadway and Arts Admissions	42
Participatory Sport Admissions	42
Movie Admissions	32
Mandatory Gratuities	32
Dues for Fraternal Societies	17
Amusement Ride Admissions	12
Luggage Carts	1
Permanent Resident of a Hotel Increased to 180 Days	1
Total	**$817**

Option 1d
Establish a Tax Reduction Reserve Fund to Finance Future Tax Relief:

Should the options for sales tax base broadening, as set out in Options 1b) and 1c) be adopted by the Legislature, the additional revenue generated could be set aside in a Tax Reduction Reserve Fund to finance future real property tax and personal income tax relief.

PACKAGE #2
Estate and Gift Tax Reform

Background

New York's estate tax is currently based on the federal estate tax laws in effect in 1998, even though the federal estate tax laws have changed dramatically since that time. As a result, the State estate tax has an exemption level of $1 million, while the federal exemption is currently $5.25 million. In addition, the federal gift tax exemption now matches the estate tax exemption — $5.25 million, while New York has no gift tax at all. Because of increases in the value of assets, such as housing, middle class households may now be subject to the estate tax because of its low threshold. The Commission suggests this situation be remedied.

Further, during the Commission's outreach meetings, tax practitioners and business leaders noted that the low exemption threshold of the estate tax was a possible factor in taxpayer migration from New York to states without an estate tax. New York is one of only 17 states with either an estate tax or an inheritance tax, while only two states, New Jersey and Rhode Island, have an exemption amount lower than New York.

2013 State Estate Taxes

State	Exemption
Connecticut	$2 million
Delaware	$5.25 million
Hawaii	$5.25 million
Illinois	$4 million
Maine	$2 million
Maryland	$1 million
Massachusetts	$1 million
Minnesota	$1 million[7]
New Jersey	$675,000
New York	$1 million
Oregon	$1 million
Rhode Island	$910,725
Vermont	$2.75 million
Washington	$2 million

[7] Minnesota also has a deduction up to $4 million for qualified farm and small business property

Options

To address the estate tax's impact on New York's competitiveness and to account for increases in asset values since the threshold was last increased, the Commission has proposed the following package of revenue neutral reforms:

- Reform the estate tax by increasing the exemption from $1 million to $3 million;
- Repeal the generation skipping tax;
- Reinstate the gift tax; and
- Close resident trust loophole.

Reform the Estate Tax and Raise the Estate Tax Exemption:

The Commission recommends that the estate tax be based on a newly restructured rate table no longer tied to the federal estate tax of 1998. The restructured tax would raise the threshold from $1 million currently to $3 million and thereby eliminate almost three-quarters of all estates from the tax. The Commission also recommends that the exemption for estates valued in excess of $3 million be phased out gradually to prevent any steep jumps in marginal tax rates. This proposal would also simplify administration of the tax by no longer linking it to the federal law at a point in time, as it is currently.

Eliminate the Generation-Skipping Tax (GST):

New York's GST was enacted in 1999. The primary purpose of the federal GST is to act as a deterrent for taxpayers seeking to avoid the estate tax by transferring property to grandchildren prior to death, usually by setting up a generation-skipping trust. Since the federal GST tax operates with the same purpose, the State GST tax is not necessary.[8]

The GST is not a major source of revenue for New York State. On average, fewer than 50 GST tax returns are filed and the tax generates less than $500,000 annually. Thus, repealing the GST would streamline New York Tax Law.

Reinstate the Gift Tax:

New York repealed its gift tax in 2000. Without a gift tax, taxpayers can easily reduce or avoid the estate tax by making lifetime gifts; therefore, a gift tax is an important complement to the estate tax. In 2010, Congress increased the federal gift tax exemption to align with the estate tax exemption, currently $5.25 million. This provision allows wealthy individuals to gift up to $5.25 million without having the amounts subject to the federal gift tax, reducing the size of their taxable estates. As New York no longer has a gift tax, the increase in gifting driven by the federal change will result in a reduction in the size of New York taxable estates, with a corresponding loss of estate tax revenue.

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[8] At one time, the federal GST provided a credit for State GST against federal GST, which offered an additional reason for imposing a State GST. That credit has been repealed, and no longer offers a reason for imposing a State GST.

The Commission proposes two options to address the impact of the federal change on New York estate tax revenues:

- Under the preferred option, New York could reinstate a gift tax, which would subject gifts above a certain threshold to tax rates in line with the New York estate tax.
- Alternatively, New York could require estates to add back the value of any gifts above a certain threshold before determining the value of its estate.

Either option has the potential to generate revenue of approximately $150 million annually.

Close Resident Trust Loophole:

Under current law, a New York resident trust is not subject to tax if all three of the following conditions are met:

- All trustees are domiciled outside the State;
- All real and tangible trust property is located outside the State; and
- All trust income and gain is derived from sources outside the State.

This treatment of resident trusts offers a tax planning opportunity known as a Delaware Incomplete Gift Trust. These trusts are treated as grantor trusts under federal gift tax law, so that the transfer is not subject to gift tax, but as non-grantor trusts for federal income tax purposes, so that the trust is a separate taxpayer from the grantor. As a result, neither the resident trust nor the New York beneficiaries of the trust pay income tax to New York. The Commission understands that the principal reason taxpayers set up these trusts is to avoid State income tax.

One option to address this issue would be to decouple from federal treatment of Delaware Incomplete Gift Trusts. These trusts would be treated as grantor trusts for New York income tax purposes. As a consequence, the trust income would be included in the taxable income of the grantor. In addition, New York could adopt California's approach, which creates an addition modification equal to distributions to resident beneficiaries by trusts not subject to California tax. This option would address concerns raised by the estate and trusts industry regarding certain proposals that have previously been offered to address this issue.

These proposals would also raise revenue for New York City from the taxpayers who set up these trusts.

PACKAGE #3
Corporate Tax Reform and Phase Out of 18-A Surcharge

Background

New York's method for taxing corporations and banking institutions dates back to the 1940's and has not been significantly restructured in more than 25 years. Reform is needed to address the following issues:

- Corporation taxes are structured in a way that discourages certain businesses from employing people in New York;
- Imposing separate taxes on banks and on general business corporations does not reflect the regulatory changes to the financial services industry. The rules for determining which corporations are taxed as banks and which are taxed as general business corporations are unworkable;
- The rules are unnecessarily complex and often unclear;
- These taxes contain numerous special deductions, exclusions and credits that complicate the law without necessarily achieving worthwhile policy objectives;
- The structure of these taxes facilitates undesirable tax planning strategies; and
- For certain taxpayers, tax burdens can be very high in relation to the amount of income earned within New York.

Currently, financial service companies and banks are taxed under different articles, despite changes in the regulatory environment more than a decade ago that permit cross ownership of finance and banking firms. For many service businesses, which continue to grow in importance to New York's economy, the corporate tax contains strong disincentives to employ people in New York. In addition, the complexity of the system invites taxpayers to take aggressive tax avoidance strategies. As a result, more than 20 percent of corporate income tax collections are received after the completion of the audit process, which can take years to resolve. This uncertainty is harmful to public corporations, who must establish reserves on their balance sheets to account for uncertain tax positions.

A comprehensive corporate tax restructuring would address these issues by creating a tax code that results in a more predictable and simplified tax structure that would ease the compliance burden for New York businesses and create greater incentives to invest and create jobs in New York.

The Commission's proposal builds upon the multi-year effort of a working group led by the Department of Taxation and Finance with broad participation from the business community.

While the working group's effort was the Commission's starting point, the Commission reviewed that proposal in depth, accepted most of its broad design, but rejected some of its specific elements. In addition, the Commission took on the issue of business tax incentive credits, a topic the working group did not address. Finally, the Commission's proposal also reflects its commitment to revenue neutral reform.

Options

The Commission's proposal would contain these key elements:

- Merge the Bank Tax (Article 32) into the Corporate Franchise Tax (Article 9-A);
- Adopt an apportionment formula based on a single receipts factor using customer sourcing rules;
- Adopt full water's-edge unitary combined filing with an ownership test of more than 50 percent;
- Expand the application of economic nexus in determining whether corporations are subject to tax;
- More effectively focus exemptions for subsidiary and investment income;
- Broaden the tax base by eliminating certain special deductions and exemptions;
- Use "effectively connected" income as the starting point for the corporate tax base calculation for non-U.S. corporations;
- Require combined reporting for all captive insurance companies;
- Repeal the "tax treaty" exception to the royalty addback provision;
- Provide for the mandatory attribution of interest expenses to exempt income with expanded direct tracing of interest expense in certain situations;
- Modify the alternative tax bases to create a credit for tax paid to other states to address possible constitutional challenges to these taxes; and
- Address the utilization of business tax incentive credits:
    - Reform the Investment Tax Credit (ITC), including limiting the credit to manufacturers of goods, as originally intended, and eliminating the credit for used property;
    - Repeal the Financial Services ITC;
    - Reform the Brownfield Credit; and
    - Reduce the Empire State Film Production Tax Credit allocation.

The Commission has determined that its corporate tax reform proposal would be approximately revenue neutral and would result in a set of changes in tax liabilities that were balanced across industry groups.[9] However, revenue estimates of a change of this magnitude are inevitably uncertain. The Commission's estimates do not attempt to account for predicted growth in revenues resulting from the positive effects of the proposed changes on business activity in New York. There is strong sentiment within the Commission, however, that corporate tax reform, implemented as described above, would generate increased economic activity in New York, leading to increased corporate tax revenues. Once some time has passed, it will be possible for the State to make more precise revenue estimates. If it is the case that corporate tax reform raises revenue, then the Commission believes that this revenue should be devoted to reductions in the corporate tax rate.

Corporate Tax Restructuring:

The most significant element of the corporate reform proposal is a merging of the bank tax into the corporate franchise tax. This would modernize the corporate tax structure to reflect today's financial services sector, simplify compliance for taxpayers and reduce tax avoidance opportunities that can arise from the two-article structure. Several other provisions follow from this unification, including the adoption of an income sourcing regime based solely on the location of the customer. The adoption of customer based sourcing will encourage increased investment and job creation in the State.

[9] The MTA business tax surcharge would be imposed at a rate sufficient to maintain its current revenue stream.

The proposal also clarifies the corporations that must file a tax return in New York by 1) requiring all firms engaged in a unitary business to file a combined return and, 2) subjecting companies that are availing themselves of New York's market to tax (economic nexus). This would allow integrated businesses, including financial service firms, to file one tax return instead of separate returns for their different lines of business. Companies would be given the opportunity to make a binding 7-year election to establish the composition of the combined group, providing certainty regarding an issue that has generated extensive audit activity.

As a result of the tax article merger and unitary filing, existing classifications of income would be eliminated (subsidiary income) or restricted (investment income). Modifications, deductions and exemptions pertaining to these income streams would be eliminated, as would certain other provisions that have become obsolete and are unnecessary in a unified tax structure.

Reform the Investment Tax Credit (ITC):

Certain capital investments in tangible property and equipment are eligible for an ITC. The wording of the statute creating the credit, however, has resulted in unintended consequences. For example, investments by non-manufacturers in equipment not used in the production of goods for sale are eligible for the credit. In addition, purchases of the assets of existing businesses are treated as new investment under the law and are eligible for the credit. Tightening up the eligibility criteria would more effectively target the State's investment toward originally intended, more productive uses.

Repeal the Financial Services ITC:

Investments in buildings and equipment used by broker/dealers are eligible for an ITC. The credit is complex, subject to extensive recapture and concentrated among relatively few taxpayers, providing benefits to an extremely limited segment of the financial services industry.

Brownfield Tax Credit Reforms:

The Legislature enacted major reforms to the State's Brownfield Tax Credit Program in 2008. The Commission suggests that there is room for additional reform to align the credit more closely with brownfield remediation.

More specifically, eligibility for the tangible property credit could be amended to include the following: 1) the site has been abandoned for 10 years, 2) redevelopment of the site would be unlikely without State assistance, as determined by the Empire State Development Corporation (ESDC), or 3) the cost of the cleanup of the site is greater than its value after cleanup. In addition, costs currently allowed under the site preparation credit that are beyond those associated with the actual cost of remediation could be scaled back or eliminated from the computation of the credit.

The Commission suggests that the credit as currently structured should be allowed to sunset as scheduled in 2015.

Reduce the Empire State Film Production Tax Credit Allocation:

The film production tax credit remains one of the State's largest tax incentives, with an annual allocation of $420 million. The program provides a refundable tax credit equal to 30 percent of "below the line" costs of films and television productions made in New York. The credit clearly appears to have had a positive effect on the level of film and television production in the State and generated jobs directly and through the multiplier effect. Further, in several respects, the credit structure includes several well-designed features. For example, the overall cost of the credit is limited by a statutory cap and each project must apply for certification and demonstrate actual cost expenditures in order to receive the credit.

Nonetheless, the Commission believes that the credit should be scaled back because it does not appear to pay for itself in its current form. Several states, including Connecticut, have been scaling back their film credits. Given the growing pressure on State resources, the State should consider scaling back the annual allocation of the credit by $50 million. In addition, the Commission suggests that the State monitor developments in other states and adjust its financial commitment as competitive conditions and budget constraints dictate.

Evaluating and Increasing the Effectiveness of Business Tax Incentives:

The number and costs of New York State tax credits available to businesses have increased significantly in recent decades. In 1994, nine business tax credits were available to taxpayers with a cost to the State of about $200 million. By 2005, there were 33 credits costing the State $673 million; in 2009, there were 38 credits costing the State $821 million. By 2013, the number off credits available to taxpayers had jumped to 50, costing the State an estimated $1.7 billion, close to triple the cost in 2005.

A small number of taxpayers account for the vast majority of tax credits claimed. In 2009, the latest year for which detailed data on credit users are available, just over 1 percent of general corporation tax filers, 0.6 percent of S Corporation filers and 1.2 percent of partnerships claimed one or more business tax credits.

In 2013, of the 50 business tax credits available to taxpayers, 37 were refundable for all or a subset of companies. Refundable tax credits operate like spending programs, in effect providing cash grants from the State to credit users. Of the 50 credits, 32 have no sunset provisions that would compel the Legislature to review whether they are worthy of statutory reauthorization and continued State funding. Because tax credits are part of the tax code and not subject to the annual appropriations process, they impose budget obligations that constrain policymakers and reduce resources for other priorities.

The State has taken some steps to address the growing cost of business incentives. Many of the larger credits have either expired (Empire Zones) or are scheduled to sunset in a few years (Brownfields). Furthermore, the costs of some of the newly enacted tax incentives, such as the Excelsior Jobs Program, are statutorily limited to contain costs and protect the State from unintended cost overruns.

The Commission suggests that the State take additional steps to evaluate the cost effectiveness of its incentive programs. These could include a periodic review of the cost/benefit of its largest programs as well as an analysis of whether they are achieving their intended goals. Furthermore, until recently there was little or no transparency as to who receives tax incentives. Recent amendments to the film production credit and Brownfield credit require some disclosure of the credit beneficiaries, but this is the exception rather than the rule. The Commission believes more could be done in this area as well.

Streamlining the Corporate Audit Process:

In addition to efficiencies resulting from the simplification of the corporate income tax, the Commission suggests that the Department of Taxation and Finance couple this effort with a streamlined audit process modeled after successful programs operated by the Internal Revenue Service.

Under the current tax structure, more than 20 percent of corporate tax collections are collected as the result of the audit process, rather than upon the filing of an initial tax return. The Commission estimates that changes in the corporate tax structure, coupled with streamlined audit procedures, could change the current audit dynamic and accelerate the collection of revenue.

Accelerate the Phase Out of the 18-A Surcharge:

The Temporary Utility Assessment (18-A Surcharge) is a two percent assessment on electric, gas, water and steam utilities. The Surcharge is scheduled to be phased out over a three and one-half year period beginning in 2014-15. The Surcharge is passed through to utility consumers as higher rates, which is a burden on families struggling to pay high utility bills. The Commission also heard from the business community that the 18-A Surcharge is particularly burdensome for New York businesses, especially those in energy intensive industries. Legislation was recently adopted to phase out this Surcharge by 2017-18. The Commission believes that, if possible, the Surcharge should be phased out more rapidly than currently scheduled. This acceleration of the phase-out can be financed from the streamlined corporate audit procedures, which are expected to produce a comparable acceleration of revenue.

New York City Corporate Tax Reform:

Ideally, New York City would conform its corporate tax laws to any new corporate tax structure adopted by the State as a result of its corporate tax reform effort. The Commission believes that it is in the State and City’s best interest for the tax bases to be conformed over the long term and recommends that further work be done to explore how New York City might best proceed to conform to the State tax, consistent with the City’s fiscal situation.

PACKAGE #4
Real Property Tax Administration

Background

This package focuses primarily on improving the administration of the local real property tax system outside New York City. The current, locally administered system is highly fragmented, with 983 county, city and town assessing units (and more than 100 village units that continue to engage in duplicative assessing of properties already assessed by a county or town). Unlike most states, New York State law does not require any uniform assessment standards or cycle for revaluation. As a result, many local tax rolls are outdated, with the last assessments performed prior to World War II in some cases. New York's system of property tax administration was recently ranked the worst in the nation by the Council of State Taxation.[10]

Options

Below are options that could be taken to improve New York's local real property tax administration include:

- Establish a Clear, Statutory Standard of Assessment;
- Require Regular Updating of Assessments;
- Modify State Aid Programs to Promote Efficiency; and
- Provide for State Assessment of Complex Properties.

Establish a Clear, Statutory Standard of Assessment:

Under current law, while assessors must assess property using a uniform percentage of value, that percentage is not established in law and varies by jurisdiction and in many cases by classes of property within a jurisdiction. This option would require that all assessors use the same standard of assessment. New York is one of only a handful of states that do not specify a statewide standard of assessment. Most states require assessments to be at 100 percent of value or some specified lesser percentage. A small minority of states allow for assessment standards that differ by property class, i.e., they permit classification of assessments.

Require Regular Updating of Assessments:

In addition to the lack of assessment standards, there is no requirement regarding the frequency of reassessments. One option is to require reassessments on periodic intervals, no less than every five years. The overwhelming majority of states specify the frequency with which assessments must be updated.

Modify State Aid Programs to Promote Efficiency:

Given the large number of separate assessing jurisdictions, State aid could be provided to encourage the greater use of shared assessment services or the consolidation of assessing units, such as shifting the function to the county level.

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[10] The Best and Worst Property Tax Administration, COST Scorecard on State Property Tax Administration, Council on State Taxation, May 2011

Require State Assessment of all Complex Commercial, Industrial, and Utility Properties:

The State Office of Real Property Tax Services (ORPTS) currently provides assessments on special franchise properties (utility and telecommunications) on the public right of way. However, assessments on similar properties on private land and assessments on other complex properties, such as power plants, are performed locally. Valuation of such properties is complex and sometimes requires skills that can be provided more efficiently at the State level.

One option that could be considered is allowing the State to provide assessments on all complex properties. This could provide some financial relief to local governments, who must secure the expertise to value complex property and who frequently must defend these assessments in court, often resulting in costly refunds. Providing a State assessment function could assist local governments and provide assessment certainty to the business community.

Policy Issues:

While these options could lead to improvements, implementation of some of them raises additional issues that should be taken into consideration.

For example, a general reassessment of real property after many years may result in shifts in the relative valuation among similarly constructed properties. For example, property values may increase more dramatically in one neighborhood than in an adjacent neighborhood in the same jurisdiction. Equalizing assessments will result in some properties' relative assessments going up, while some would be decreased and others see no change at all in their relative valuation. However, it must be understood that the goal of the reassessment process is to create a fair distribution of the tax burden, i.e., according to the value of each property.

Despite a relative lack of State standards, over 70 percent of New York's 983 county, city and town assessing units currently have uniform assessment rolls as a result of having conducted a recent reassessment. This demonstrates the substantial progress that has been made since the 1980s, when fewer than 20 percent had current, equitable rolls. Other indicators of progress are the nearly universal adoption of the State-provided computer system for assessment administration, and the approximately half of all assessing jurisdictions that now employ professional assessors who assess in multiple jurisdictions.

Conducting periodic reassessments does impose costs on local governments. Given the current financial constraints facing local governments, State policymakers might want to enhance current State aid programs, such as the per-parcel cyclical reassessment aid program offered by the ORPTS, to cover a greater share of the costs incurred if the State were to institute a mandatory reassessment cycle.

PACKAGE #5
Tax Simplification

Background

This set of options would simplify tax compliance and improve the efficiency of tax administration. Some of these proposals require legislation; others do not. Some of these options have modest one-time or recurring fiscal impacts. The Commission believes that these costs are sufficiently modest to be manageable through the normal budget-making process or by redirecting revenue generated by other proposals put forward in this report.

Options

Repeal Nuisance Taxes:

Repeal "Add On" Minimum Tax in the Personal Income Tax (PIT):

- PIT contains an additional tax that applies to limited categories of income.
- This additional tax pre-dates the 1986 tax reforms.
- Only 200 taxpayers pay the tax, which generates just $200,000 annually.
- New York is sometimes penalized in tax rankings because these provisions make the State's tax code more complex and burdensome.

Repeal Stock Transfer Tax:

- The Stock Transfer Tax imposes a tax on the sale or transfer of stock.
- The tax generates $12 billion a year that is 100 percent rebated to taxpayers.
- The tax has been 100 percent rebated since 1981.
- The tax was used as additional security for the NYC Municipal Assistance Corporation (MAC) bonds, but the MAC Bonds were retired in 2008 so the tax is no longer needed for this purpose.
- Sales of stock in privately held family businesses and purchases of shares in a residential cooperative require purchases of actual physical tax stamps.
- In the event New York should ever want to raise revenue from a tax on securities transactions (an issue not addressed by the Commission), the existing tax would not be a useful model for any such tax, so keeping it on the books serves no purpose.

Repeal the Tax on Agricultural Cooperatives:

- The §185 tax on agricultural cooperatives is a franchise tax on the value of stock issued by an agricultural cooperative; non-stock ag-coops are exempt from this tax.
- Only 45 taxpayers pay this tax: the median tax is $160, one-third pay only $10.
- The Department of Taxation and Finance pays out more in refundable Empire Zone Program tax credits than it collects in §185 taxes.

Repeal the Organization Tax on In-State Corporations and the License Fee on Out-of-State Corporations:

- New businesses to New York must file and pay an Organization Tax (NY corporations) or a License Fee (out-of-state corporations).
- Companies can manipulate their structures to minimize their tax.
- Approximately 70,000 businesses pay a total of $9 million each year.
- The business community has expressed the opinion that this is a nuisance tax.

Replace the Boxing and Wrestling Tax with Sales Tax:

- The Boxing and Wrestling Tax is 3 percent of the gross receipts and broadcasting rights earned.
  - Event promoters must file one return for admissions receipts and two separate returns for broadcast rights receipts.
  - Tax is capped at $100,000 per event (each component is capped at $50,000) and generates $400,000 a year.
- Other sporting events (e.g., Yankees, Knicks) are taxed through a sales tax on admissions charges.
  - The sales tax is collected by sports venues, not promoters, and is shared with local governments.
- A shift to sales tax would be revenue neutral for New York State, but would generate $500,000 a year for local governments.

Making Filing Easier

Personal Income Tax Filing (PIT):

Raise the Income Level that Triggers Requirement to File a Personal Income Tax Return:

- Households with income of $4,000 or more must file PIT returns whether or not they owe taxes to New York.
  - The current threshold was set in 1987.
- Raising the filing threshold to the current standard deductions (e.g., $15,400 for married couples) would eliminate filing for approximately 270,000 taxpayers who owe no New York tax and are not eligible for any refunds, one-fourth of whom are seniors.
  - The Internal Revenue Service (IRS) uses a similar standard.

Modify Signature Requirements on e-Filed Returns Prepared by Tax Professionals:

- Eliminate the requirement that a tax professional obtain a signed signature document from his or her client prior to transmitting a return through the Federal/State program.
- Replace that requirement with certification language that states that the preparer has provided a copy of the return that is being filed to the taxpayer, and that the taxpayer has authorized the preparer to e-file it.
- The current rule is burdensome for tax professionals and is a barrier to electronic filing.

Simplify Filing of Amended Personal Income Tax Returns:

- Taxpayers who need to file amendments to previously filed returns must re-file the entire return rather than just filing the changes.
- Approximately 120,000 amended returns are filed each year.
  - This would follow current IRS practice.

Eliminate Obsolete Additions and Subtractions:

- New York Adjusted Gross Income is determined through additions or subtractions to federal Adjusted Gross Income.
- Many of these additions and subtractions date back decades and are obsolete.
- Eliminating obsolete additions and subtractions would simplify the tax code, making it easier to file a return.

Eliminate Household Credit Offset from the Calculation of the Earned Income Tax Credit (EITC)[11]:

- Under current law, the amount of the EITC claimed by a taxpayer must be reduced by the amount of the Household Credit, if any.
- Eliminating the offset would simplify the tax code as the Household Credit offset is a complication for taxpayers.
- No other state with an EITC has such a provision.
- The elimination of the offset would reduce State tax revenue by $30 million annually.

Eliminate Personal Income Tax for Nonresidents Who Perform Work in New York on a Very Limited Basis:

- Currently, nonresident individuals working any days in New York during the year are subject to New York taxes on income earned on those days.
  - The business community has indicated this provision discourages business travel to New York and harms the convention and trade show business.
- Establishing a 14-day threshold before a nonresident would owe New York taxes would reduce State revenue by $50 million annually. The threshold would not apply to athletes and entertainers performing in New York, as well as nonresidents maintaining a permanent place of abode in New York.
- Legislation has been introduced in Congress to mandate a 30-day *de minimis* rule. The Commission believes the 14-day rule is a more appropriate response to the tax compliance burdens associated with *de minimis* amounts of routine business travel.

Sales Tax Filing:

Increase the Sales Tax Annual Filing Threshold:

- Sales tax returns must be filed quarterly or annually depending on the amount of tax collected.
  - Vendors can file annually if their total sales tax collections are less than $3,000 a year.
  - Currently, 260,000 vendors file annually.
- Raising the threshold to $5,000 would allow an additional 20,000 businesses to file annually.

[11] This proposal could be combined with the option to enrich the Household Credit, discussed in Package #1.

Create a Sales Tax Annual Filing Option for New Small Businesses:

- New businesses are required to file quarterly sales tax returns for nearly two years to demonstrate that they meet the requirements for annual filing (currently less than $3,000 in annual sales tax collections).
- Allowing new businesses to file annually if they have a reasonable expectation that they would meet the annual filing threshold would ease sales tax compliance for approximately 30,000 new businesses each year.

Simplify the Filing of Final Sales Tax Returns:

- Businesses that have ended business or have restructured to a different business form (e.g., to an LLC) must file their final sales tax returns within 20 days.
- This filing deadline is burdensome to businesses because it does not conform to standard filing dates.
- Allowing businesses to file their final returns when the next returns are due would simplify filing for the approximately 80,000 businesses that restructure or end business in a given year.

Simplify Sales Tax Filing for Temporary Vendors:

- Thousands of temporary vendors (e.g., Christmas tree sellers) must file sales tax returns on the same quarterly schedule as other retailers.
- These “temporary vendors” could be allowed to file their sales tax returns immediately after their last sale in New York.

Help Businesses Determine the Correct Local Sales Tax Rates:

- Many businesses, especially online retailers, report sales taxes to the wrong jurisdiction and charge the incorrect tax rate – largely because ZIP codes do not align with municipal boundaries.
- The Department of Taxation and Finance has a jurisdiction lookup service to help vendors collect the proper amount of tax, which should be upgraded to allow for integration into vendors’ online billing systems.
    - An integrated system would help ensure that sales tax collections are credited to the proper jurisdictions.

Other Filing Simplifications:

Allow Self-Employed Individuals to Pay their MTA Mobility Tax on their Personal Income Tax Return:

- About 65,000 self-employed individuals with income above $50,000 annually are required to pay the MTA Mobility Tax.
- These taxpayers must make estimated payments and file final MTA Mobility Tax returns on different dates than the dates for PIT.
- Allowing MTA Mobility Tax returns to be filed in conjunction with PIT returns would simplify tax compliance for these taxpayers.

Combine the MTA Surcharge Return with the Main Corporate Tax Return:

- Businesses located in the MTA region must file both the main corporate tax return and a separate tax return to pay the MTA business tax surcharge.
- Combining these two returns would simplify the filing of the surcharge for the 75,000 businesses that are subject to the MTA surcharge.

Allow Limited Liability Companies (LLCs) and Partnerships to Pay Annual Filing Fees at Time of Personal Income Tax Filings:

- Over 240,000 businesses partnerships and LLCs must pay annual filing fees by the beginning of March while the associated PIT returns are typically due on April 15th.
- These different filing dates create a compliance burden for tax practitioners.
- New York State Society of CPAs and others have suggested synchronization of these filing dates.
- Moving the annual filing fee due date to April 15th would result in a one-time revenue spin down of $65 million.

Allow Small Producers and Distributors to File Alcoholic Beverage Tax Returns Annually:

- Alcoholic beverage producers and distributors must file monthly Alcohol Beverage Tax returns.
  - Farm wineries and farm breweries can elect to file annually.
- Allowing small producers and distributors (including small breweries, wineries and distillers) to file annually would benefit 1,800 businesses, largely located upstate.

Greater Coordination Between New York State and New York City:

Increase Utilization of Joint State and City Audits:

- Currently, taxpayers liable for both State and City franchise taxes are subject to separate audits.
- The State Department of Taxation and Finance and the City Department of Finance currently conduct only a few dozen joint audits each year, even though the universe of common taxpayers is much larger.
- Increasing the degree of coordination between State and City audits would minimize the information requests made of taxpayers, expedite the completion of audits and increase certainty and predictability for taxpayers.

Adopt a State and City Compliance Assurance Process (CAP):

- A State and City CAP would allow taxpayers to proactively discuss and resolve material issues prior to filing tax returns and being audited.
  - The IRS CAP Program has led to a reduction or, in some cases, the complete elimination of post-filing audits that can take years to complete.
- A State and City CAP has the potential to speed up corporate tax collections by increasing taxes paid when returns are filed rather than years later on audit.

Conform the State and City Sales Tax on Hotel Occupancy:

- A "permanent resident" of a hotel is not subject to sales tax on hotel occupancy.
  - The State defines permanent residency as occupancy over 90 days.
  - The City defines permanent residency as occupancy over 180 days for sales tax and for the City hotel occupancy tax.
- Conforming the State definition to the City definition would simplify the calculation of the tax for 800 hotels located in the City.

Jointly Administer State and City Cigarette Registration Certificates:

- The State and City require retailers who sell cigarettes to obtain separate annual registration certificates.
  - City retailers register with the City Department of Finance but often are unaware that there is a separate State registration requirement.
- Retailers selling cigarettes without a valid State certificate are subject to a $5,000 penalty.
- Making a joint registration available would simplify the registration requirement for about 10,000 retailers, mostly small convenience stores.

Local Utility and Telecommunications Taxes:

Repeal Local Utility Gross Receipts Taxes (GRT) and School District Sales Taxes and Replace with an Increased State Gross Receipts Tax; or Repeal Local Gross Receipts Tax on Telecommunications and Modernize the Local Gross Receipts Tax on Utilities:

- Cities (other than New York City) and villages can impose local GRT on telecommunication and utility companies for services that start and end within their jurisdictions.
  - Fifty-six cities and 363 villages impose a one percent GRT.
  - Rochester, Buffalo, and Yonkers can impose a three percent GRT.
- Local GRT compliance is burdensome for industry.
  - Each jurisdiction requires a separate filing; large companies may file hundreds of returns each year.
  - Very difficult to determine whether services are wholly within one jurisdiction and thus taxable.
- Small city school districts are permitted to impose a three percent sales tax on telecommunications and utility services that is billed to utility customers.
  - This local sales tax dates back to 1947 – before State tax was imposed.
- Tax generates $32 million for the 24 small city school districts that impose this sales tax.
  - In many of these areas the combined sales tax rate on these services is 11 percent.
  - Small city school districts imposing this tax can be in cities that also impose the local GRT on these services.
- Tax compliance is burdensome for industry.

Options:

- Repeal local GRT and school districts sales tax;
- Replace lost revenue by increasing the State GRT, and distribute to local governments to hold them harmless; or

- Repeal the local GRT on telecommunications and modernize the local GRT on energy to ensure the stability of this local revenue source.

These options would not apply to New York City, which has a well-developed administrative structure for its utility gross receipts taxes.

Motor Fuel Tax Simplification:

New York State's current system for taxing motor fuel applies multiple taxes on the same gallon of motor fuel (primarily gasoline) or highway diesel motor fuel at the same imposition point. The State's excise tax, petroleum business tax (PBT), and prepaid sales tax are imposed on the first import of motor fuel into the State.

Options:

The tax bases of the motor fuel and PBT are not identical, as some products are exempt from one, but partially exempt from the other. The State could consider merging the two taxes into one tax, which would reflect how taxpayers currently file with the Department of Taxation and Finance. In addition, the State should consider synchronizing the fuel tax exemptions so that they are consistent across the motor fuel tax, the PBT, and the sales tax. In addition, the State could consider eliminating the indexing of the PBT rate to stabilize the tax rates. While combining the two taxes and eliminating rate indexing would have no fiscal impact with respect to the current Financial Plan, equalizing the exemptions across the various taxes would result in a revenue loss of approximately $47 million when fully effective.

AREAS FOR FUTURE STUDY

Telecommunication Taxes

After a preliminary review of the current taxation of the telecommunications industry, the Commission concluded that this topic required a study of its own that could not be completed within the Commission's time frame. No other industry has undergone such rapid change. As a result, nowhere are the tax laws more out-of-date than in their taxation of this industry.

The Commission recommends that a working group undertake a comprehensive study of the taxation of the telecommunications industry, including, but not limited to, real property taxes, state and local excise taxes, franchise taxes, and sales and use tax and provide options or recommendations for improvement.

Utility Taxes

The Commission also recommends a study of the taxation of all utilities. Because deregulation has blurred the lines between regulated companies and other providers of utility services, the rationale for differentiating between Article 9-A corporation franchise taxpayers and Article 9 taxpayers is becoming less apparent.

APPENDICES

This Appendix consists of the six reports prepared by the Office of Tax Policy Analysis of the New York State Department of Taxation and Finance at the request of and specifically for the Tax Reform and Fairness Commission. Electronic copies of the reports may be obtained from the Department's website (http://www.tax.ny.gov/research/stats/statistics/collect_policy_stat_reports.htm).

New York State Tax Burden Study

Prepared for the New York State Tax Reform and Fairness Commission

April 2013

Introduction

One of the fundamental questions policy makers ask about taxation is "Who pays taxes?" This question strikes at one of the key criteria for evaluating tax system design – tax equity. While everyone agrees that the burden of taxation should be distributed fairly, there is disagreement about what is "fair". In order to analyze fairness, public finance economists have developed definitions of equity based on an individual's ability to pay. Horizontal equity requires that people with equal capacity should pay the same amount of tax, while vertical equity states that people with greater ability should pay more.

This study focuses on the vertical equity of New York's tax system through the measurement of three of New York's major taxes paid by individuals: the personal income tax, the sales tax, and the real property tax. Although portions of the sales and property taxes are paid by business, this report will focus solely on the taxes paid by individuals. Together, these three taxes represent over 80 percent of total state and local taxes levied in New York. A tax structure that closely reflects ability-to-pay is referred to as being progressive – where the ratio of tax paid to income rises as incomes rise. A tax is regressive where the ratio of tax paid to income falls as incomes rise.

There are two methodologies that can be utilized to measure the incidence or burden of taxes. One approach relies on a macro analysis in which taxes in the aggregate are distributed among income groups. This type of analysis was undertaken for New York State by the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law back in 1985. The Commission retained Professor Donald Phares, who had written a book that contained tax incidence analyses of the fifty states, to do a comparative analysis of New York and other locations around the country entitled "Who Pays New York Taxes?" More recently, the Institute on Taxation and Economic Policy (ITEP) published its 2013 report, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States." These types of studies rely on sophisticated simulation models where data regarding income taxes, consumption expenditures, and property tax information are merged together. In addition, a series of assumptions are made about tax shifting. The results demonstrate whether a state's tax structure is progressive or regressive. For New York State, these studies find that the overall state and local tax structure is somewhat regressive, comprised of a highly progressive income tax that is more than offset by regressive sales and property taxes.

The second approach that measures who pays taxes uses a micro analysis based on individual representative taxpayer profiles created from actual tax data. The Legislative Commission cited above also released a companion study in 1985, "Interstate Tax Comparisons: Individual Taxpayers", which analyzed state and local tax burdens in New York State (as well as New York City) and 15 other locations around the country for a series of representative taxpayers. The purpose of that study was to show how tax burdens in New York compared with those in other states. This report will use the micro approach to illustrate how the state and local tax burden in New York is distributed across not just income classes, but also particular taxpayer characteristics such as age, marital status, housing situation, and geographic location.

New York State Personal Income Tax – Representative Taxpayers

Methodology

The Office of Tax Policy Analysis (OTPA) developed a model that computes simultaneous Federal, New York State and New York City income tax liabilities for selected representative taxpayers. Examples can be produced for single, head of household, and married taxpayers filing jointly.

For the purposes of this report, various representative taxpayer examples were developed for selected income levels and filing statuses. Each taxpayer has a particular profile based upon a review of available aggregate income tax data. Profiles include different types of income (e.g., wages, pensions, and unearned income such as interest, dividends and capital gains) and itemized deductions. Specified Federal Gross Income (FGI)/Federal Adjusted Gross Income (FAGI) levels range from $15,000 to $5,000,000.

Taxpayers are generally assumed to itemize deductions when their income exceeds $100,000, but in some cases New York City residents may become Federal itemizers at a lower income level because of the deductibility of the New York City income tax. Taxpayers are assumed to claim the most common itemized deductions for real property taxes paid, mortgage interest and charitable contributions. Federal taxpayers also deduct New York State and New York City income taxes (where applicable).[1]

Tax liability for each taxpayer is calculated based upon generally available features of the respective tax systems such as standard or itemized deductions, personal or dependent exemptions, and broadly available credits claimed by taxpayers, such as child tax credits or earned income tax credits. Credits that are not generally available are not included in the calculations. Certain Federal taxpayers may also be subject to the Alternative Minimum Tax (AMT) and the new Federal tax on net investment income that was created pursuant to the passage of the *Patient Protection and Affordable Care Act* (P.L. 111-148).

Discussion

The results for the various income levels and filing statuses are presented in Tables 1-3 (Federal Personal Income Tax), Tables 4-6 (New York State Personal Income Tax), and Tables 7-9 (New York City Personal Income Tax). For Federal and New York State taxes, results are presented for both New York City residents and other New York taxpayers. As the New York City income tax is imposed only on NYC residents, New York City income tax figures are shown for New York City residents only.

Federal Personal Income Tax

Tables 1-3 show that the Federal Personal Income Tax is highly progressive as incomes rise across the specified ranges. For single taxpayers (Table 1), effective tax rates increase from 3.33 percent to 29.33 percent (for New York City taxpayers) and 3.33 percent to 31.02 percent elsewhere in New York State.

A similar pattern emerges for married taxpayers filing jointly with 2 dependents (Table 2). However, in these instances lower-income taxpayers benefit from refundable Federal credits including the Earned Income Tax Credit (EITC) and the Child Tax Credit/Additional Child Tax Credit. As a result, for these taxpayers, effective tax rates increase from -47.71 percent to 28.20 percent (for New York City taxpayers) and -47.71 percent to 29.88 percent elsewhere in New York State.

In contrast, lower-income married taxpayers filing jointly age 65 and over without dependents (Table 3) fail to benefit from the child-related refundable credits. For these taxpayers, effective tax rates increase from 0.00 percent to 22.78 percent (for New York City taxpayers) and 0.00 percent to 22.96 percent elsewhere in New York State. The lower effective tax rates that these taxpayers face at higher income levels is largely because they benefit from lower Federal tax rates on unearned income (e.g., long-term capital gains and qualified dividends). These items form a far larger share of their income than their younger married counterparts.

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[1]The impact of Federal deductibility is reflected in reduced effective tax rates under the Federal individual income tax. An alternative way to show this impact is through reduced New York State and New York City effective tax rates. Irrespective of how these results are presented, the overall impact remains the same even though the relative progressivity of the Federal or New York State/City taxes may change somewhat.

Where Federal tax rates are lower for New York City residents than taxpayers located elsewhere in New York State, the primary cause is the additional itemized deductions generated by the New York City personal income tax paid.

Table 1. Federal Personal Income Tax for Single Taxpayers

		New York City Taxpayer			Outside NYC		
Income		Tax Liability		Effective Tax Rate % 1/	Tax Liability		Effective Tax Rate % 1/
$	15,000	$	500	3.33%	$	500	3.33%
$	25,000	$	1,802	7.21%	$	1,802	7.21%
$	50,000	$	5,927	11.85%	$	5,927	11.85%
$	75,000	$	12,117	16.16%	$	12,165	16.22%
$	100,000	$	17,686	17.69%	$	18,420	18.42%
$	250,000	$ /2	53,554	21.42%	$ /2	53,554	21.42%
$	500,000	$ /2	124,202	24.84%	$ /2	124,202	24.84%
$	1,000,000	$	268,918	26.89%	$	284,361	28.46%
$	2,000,000	$	519,874	25.99%	$	552,607	27.63%
$	5,000,000	$	1,466,705	29.33%	$	1,551,023	31.02%

1/ Calculated as total Federal Personal Income tax plus Federal tax on net investment income over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).
2/ Includes Alternative Minimum Tax (AMT).

Table 2. Federal Personal Income Tax for Married Taxpayers (2 Dependents) Filing Jointly.

		New York City Taxpayer			Outside NYC		
Income		Tax Liability		Effective Tax Rate % 1/	Tax Liability		Effective Tax Rate % 1/
$	15,000	$	-7,156	-47.71%	$	-7,156	-47.71%
$	25,000	$	-6,923	-27.69%	$	-6,923	-27.69%
$	50,000	$	424	0.85%	$	424	0.85%
$	75,000	$	4,152	5.54%	$	4,152	5.54%
$	100,000	$	5,668	5.67%	$	6,043	6.04%
$	250,000	$ /2	42,408	16.96%	$ /2	42,408	16.96%
$	500,000	$ /2	121,408	24.28%	$ /2	121,408	24.28%
$	1,000,000	$ /2	258,857	25.89%	$	264,445	26.44%
$	2,000,000	$	510,063	25.50%	$	542,702	27.14%
$	5,000,000	$	1,409,880	28.20%	$	1,493,948	29.88%

1/ Calculated as total Federal Personal Income Tax plus Federal Tax on net investment income over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).
2/ Includes Alternative Minimum Tax (AMT).

Table 3. Federal Personal Income Tax for Married Taxpayers (Age 65+, 0 Dependents) Filing Jointly.

		New York City Taxpayer			Outside NYC		
Income		Tax Liability		Effective Tax Rate % 1/	Tax Liability		Effective Tax Rate % 1/
$	15,000	$	0	0.00%	$	0	0.00%
$	25,000	$	188	0.75%	$	188	0.75%
$	50,000	$	3,105	6.21%	$	3,105	6.21%
$	75,000	$	6,533	8.71%	$	6,533	8.71%
$	100,000	$	9,437	9.44%	$	9,652	9.65%
$	250,000	$ /2	41,905	16.76%	$ /2	41,905	16.76%
$	500,000	$ /2	116,404	23.28%	$ /2	116,404	23.28%
$	1,000,000	$ /2	235,053	23.51%	$ /2	236,683	23.67%
$	2,000,000	$ /2	491,107	24.56%	$	495,184	24.76%
$	5,000,000	$ /2	1,139,085	22.78%	$ /2	1,147,967	22.96%

1/ Calculated as total Federal Personal Income Tax plus Federal Tax on net investment income over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).
2/ Includes Alternative Minimum Tax (AMT).

New York State Personal Income Tax

Tables 4-6 show that effective rates under New York State's Personal Income Tax follow a progressive trend as incomes increase much like the Federal Income Tax. For example, for single taxpayers (Table 4), effective tax rates increase from 1.65 percent to 8.66 percent for all New York State taxpayers, regardless of whether they live in – or outside - New York City.

A similar pattern emerges for married taxpayers filing jointly with 2 dependents (Table 5). However, as with the Federal Income Tax, lower-income taxpayers benefit from refundable New York State tax credits including the New York State Earned Income Tax Credit (NYS EITC) and the Empire State Child Credit (ESC). As a result, for these taxpayers, effective tax rates increase from -14.71 percent to 8.64 percent (for taxpayers both in and outside New York City).

In contrast, lower-income married taxpayers filing jointly age 65 and over without dependents (Table 6) fail to benefit from the child-related refundable New York State credits. For these taxpayers, effective tax rates increase from 0.00 percent to 8.15 percent (for New York City taxpayers and elsewhere). Many of these taxpayers face lower effective tax rates, however, because a significant amount of their income is exempt from New York State tax – i.e., Social Security income and a large portion of pension income.

Table 4. New York State Personal Income Tax for Single Taxpayer

Income		New York City Taxpayer Tax Liability		New York City Taxpayer Effective Tax Rate % 1/	Outside NYC Tax Liability		Outside NYC Effective Tax Rate % 1/
$	15,000	$	247	1.65%	$	247	1.65%
$	25,000	$	768	3.07%	$	768	3.07%
$	50,000	$	2,403	4.81%	$	2,403	4.81%
$	75,000	$	4,015	5.35%	$	4,015	5.35%
$	100,000	$	5,658	5.66%	$	5,658	5.66%
$	250,000	$	15,388	6.14%	$	15,388	6.14%
$	500,000	$	31,263	6.25%	$	31,263	6.25%
$	1,000,000	$	64,485	6.45%	$	64,485	6.45%
$	2,000,000	$	169,873	8.49%	$	169,873	8.49%
$	5,000,000	$	433,062	8.66%	$	433,062	8.66%

1/ Calculated as total New York State Personal Income Tax over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).

Table 5. New York State Personal Income Tax for Married Taxpayers (2 Dependents) Filing Jointly.

Income		New York City Taxpayer Tax Liability		New York City Taxpayer Effective Tax Rate % 1/	Outside NYC Tax Liability		Outside NYC Effective Tax Rate % 1/
$	15,000	$	-2,206	-14.71%	$	-2,206	-14.71%
$	25,000	$	-1,840	-7.36%	$	-1,840	-7.36%
$	50,000	$	831	1.66%	$	831	1.66%
$	75,000	$	2,397	3.20%	$	2,397	3.20%
$	100,000	$	3,680	3.68%	$	3,680	3.68%
$	250,000	$	14,711	5.88%	$	14,711	5.88%
$	500,000	$	30,778	6.16%	$	30,778	6.16%
$	1,000,000	$	63,945	6.39%	$	63,945	6.39%
$	2,000,000	$	131,726	6.59%	$	131,726	6.59%
$	5,000,000	$	432,004	8.64%	$	432,004	8.64%

1/ Calculated as total New York State Personal Income Tax over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).

Table 6. New York State Personal Income Tax for Married Taxpayers (Age 65+, 0 Dependents) Filing Jointly.

Income		New York City Taxpayer Tax Liability		New York City Taxpayer Effective Tax Rate % 1/	Outside NYC Tax Liability		Outside NYC Effective Tax Rate % 1/
$	15,000	$	0	0.00%	$	0	0.00%
$	25,000	$	0	0.00%	$	0	0.00%
$	50,000	$	0	0.00%	$	0	0.00%
$	75,000	$	584	0.78%	$	584	0.78%
$	100,000	$	1,203	1.20%	$	1,203	1.20%
$	250,000	$	10,817	4.33%	$	10,817	4.33%
$	500,000	$	27,415	5.48%	$	27,415	5.48%
$	1,000,000	$	60,013	6.00%	$	60,013	6.00%
$	2,000,000	$	127,883	6.39%	$	127,883	6.39%
$	5,000,000	$	407,290	8.15%	$	407,290	8.15%

1/ Calculated as total New York State Personal Income Tax over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).

New York City Personal Income Tax

Tables 7-9 show that effective rates under New York City's Personal Income Tax are very progressive, much like the Federal Income Tax and New York State Personal Income Tax, although at lower rates. For example, for single taxpayers (Table 7), effective tax rates increase from 1.00 percent to 3.78 percent for New York City residents.

Table 8 (married taxpayers filing jointly with 2 dependents) also demonstrates the progressive nature of the City tax. As with the Federal and State Income Taxes, lower-income taxpayers benefit from a refundable New York City Earned Income Tax Credit (NYC EITC), and many taxpayers also benefit from the New York City STAR property tax credit. As a result, for these taxpayers, effective tax rates increase from -2.62 percent to 3.77 percent.

Married taxpayers filing jointly age 65 and over without dependents (Table 9) fail to benefit from the NYC EITC, but can claim a STAR credit. Moreover, because New York City taxable income is the same as New York State taxable income, these taxpayers benefit from the favorable treatment of Social Security and pension income. Effective tax rates for these taxpayers increase from -0.83% percent to 3.55 percent.

Table 7. New York City Personal Income Tax for Single Taxpayer

		New York City Taxpayer			Outside NYC		
Income		Tax Liability		Effective Tax Rate % 1/	Tax Liability		Effective Tax Rate % 1/
$	15,000	$	150	1.00%	$	N/A	N/A
$	25,000	$	474	1.89%	$	N/A	N/A
$	50,000	$	1,367	2.73%	$	N/A	N/A
$	75,000	$	2,275	3.03%	$	N/A	N/A
$	100,000	$	3,187	3.19%	$	N/A	N/A
$	250,000	$	8,013	3.21%	$	N/A	N/A
$	500,000	$	16,531	3.31%	$	N/A	N/A
$	1,000,000	$	35,230	3.52%	$	N/A	N/A
$	2,000,000	$	73,394	3.67%	$	N/A	N/A
$	5,000,000	$	189,054	3.78%	$	N/A	N/A

1/ Calculated as total New York City Personal Income Tax over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).

Table 8. New York City Personal Income Tax for Married Taxpayers (2 Dependents) Filing Jointly.

		New York City Taxpayer			Outside NYC		
Income		Tax Liability		Effective Tax Rate % 1/	Tax Liability		Effective Tax Rate % 1/
$	15,000	$	-394	-2.62%	$	N/A	N/A
$	25,000	$	-150	-0.60%	$	N/A	N/A
$	50,000	$	892	1.78%	$	N/A	N/A
$	75,000	$	1,782	2.38%	$	N/A	N/A
$	100,000	$	2,497	2.50%	$	N/A	N/A
$	250,000	$	7,733	3.09%	$	N/A	N/A
$	500,000	$	16,179	3.24%	$	N/A	N/A
$	1,000,000	$	34,830	3.48%	$	N/A	N/A
$	2,000,000	$	73,183	3.66%	$	N/A	N/A
$	5,000,000	$	188,494	3.77%	$	N/A	N/A

1/ Calculated as total New York City Personal Income Tax over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).

Table 9. New York City Personal Income Tax for Married Taxpayers (Age 65+, 0 Dependents) Filing Jointly.

		New York City Taxpayer			Outside NYC		
Income		Tax Liability		Effective Tax Rate % 1/	Tax Liability		Effective Tax Rate % 1/
$	15,000	$	-125	-0.83%	$	N/A	N/A
$	25,000	$	-125	-0.50%	$	N/A	N/A
$	50,000	$	-125	-0.25%	$	N/A	N/A
$	75,000	$	299	0.40%	$	N/A	N/A
$	100,000	$	715	0.71%	$	N/A	N/A
$	250,000	$	5,670	2.27%	$	N/A	N/A
$	500,000	$	14,388	2.88%	$	N/A	N/A
$	1,000,000	$	32,605	3.26%	$	N/A	N/A
$	2,000,000	$	71,009	3.55%	$	N/A	N/A
$	5,000,000	$	177,634	3.55%	$	N/A	N/A
1/ Calculated as total New York City Personal Income Tax over Federal Gross / Federal Adjusted Gross Income (FGI/FAGI).							

The Combined Income Tax Burden

This section portrays the effective tax rates for the combination of the three income taxes. For illustrative purposes, the married taxpayer status with two dependents was chosen. Table 10 shows the combined burden for these taxpayers under the New York State and New York City personal income taxes. As previously noted, these respective taxes are highly progressive in that the ratio of tax paid to income (i.e., effective tax rates) rise as incomes rise.

Effective rates under New York State's personal income tax increases from -14.71 percent for lower-income taxpayers to 8.64 percent those for taxpayers with the highest incomes. Similarly, effective tax rates for New York City's personal income tax rise from -2.62 percent to 3.77 percent. The combined effective tax rates for both taxes range from -17.33 percent to 12.41 percent for the most affluent taxpayers. Figure 1 below illustrates in a graphical form these effective rates by income class for taxpayers who live in New York City and for those who live outside the City.

The same patterns hold true when Federal Income Tax is included in the analysis (see Table 11). However, Federal income tax rates dwarf New York State and New York City rates. The top Federal marginal rate, for instance, is 39.6 percent (plus a 3.8 percent tax on certain unearned income), while the top New York State personal income tax rate is 8.82 percent and the top New York City rate is 3.876 percent.

As Table 11 shows, effective Federal tax rates range from -47.71 percent to 29.88 percent for New York State residents living outside New York City. For City residents, effective tax rates range from -47.71 percent to 28.20 percent. This differential is caused by the Federal deductibility of the New York City tax for some taxpayers, although in some cases the value of this deduction is offset by the impact of the Federal Alternative Minimum Tax (AMT).

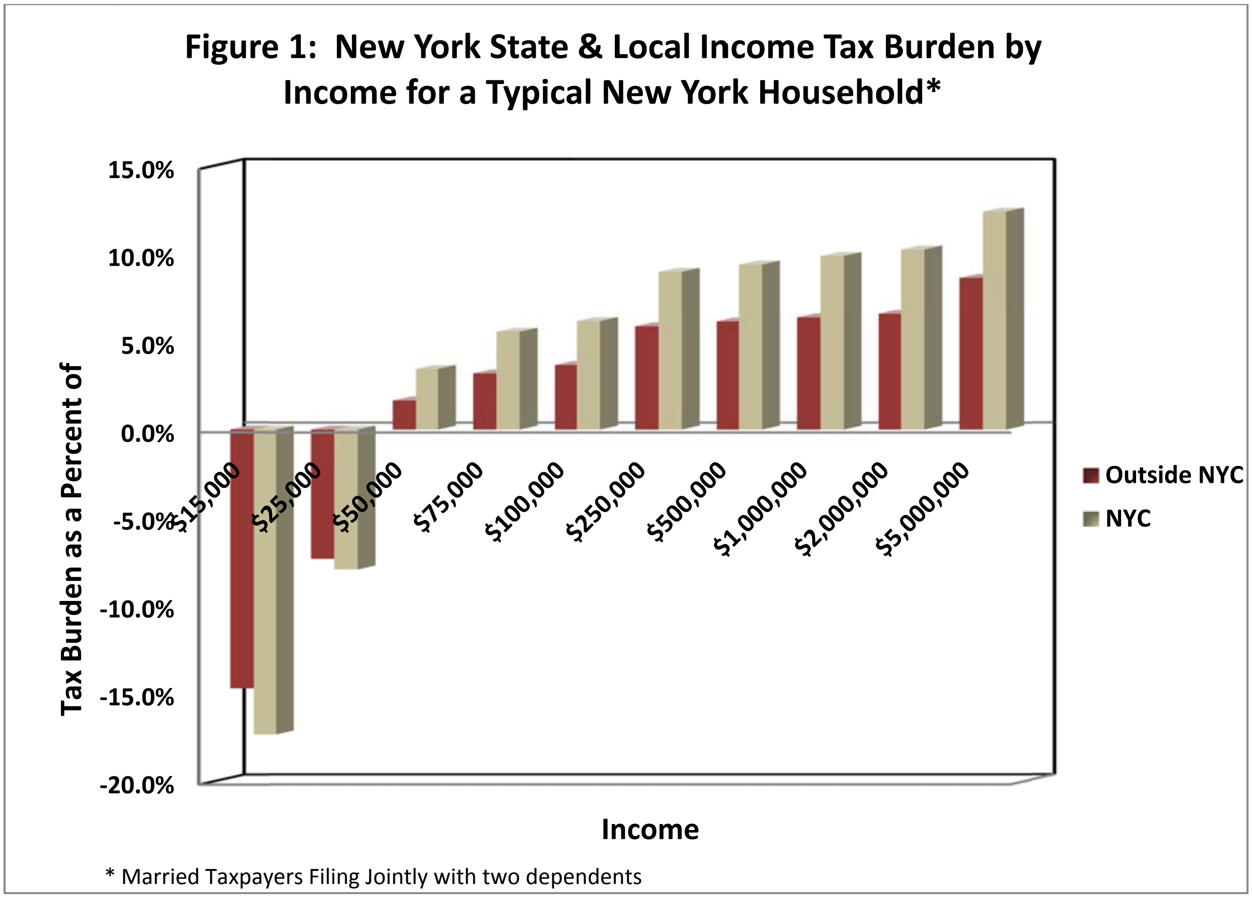
When Federal, New York State and New York City taxes are combined, overall effective tax rates range from -62.41 percent to 38.52 percent for New York State residents outside New York City. For City residents, overall effective tax rates range from -65.04 percent to 40.61 percent.

Table 10. Combined New York State & New York City Personal Income Tax for Married Taxpayers (2 Dependents) Filing Jointly.

		New York State Tax		New York City Tax	Combined NYS & NYC Income Taxes	
		NYC	Outside NYC	NYC	NYC	Outside NYC
Income		Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %
$	15,000	-14.71%	-14.71%	-2.62%	-17.33%	-14.71%
$	25,000	-7.36%	-7.36%	-0.60%	-7.96%	-7.36%
$	50,000	1.66%	1.66%	1.78%	3.45%	1.66%
$	75,000	3.20%	3.20%	2.38%	5.57%	3.20%
$	100,000	3.68%	3.68%	2.50%	6.18%	3.68%
$	250,000	5.88%	5.88%	3.09%	8.98%	5.88%
$	500,000	6.16%	6.16%	3.24%	9.39%	6.16%
$	1,000,000	6.39%	6.39%	3.48%	9.88%	6.39%
$	2,000,000	6.59%	6.59%	3.66%	10.25%	6.59%
$	5,000,000	8.64%	8.64%	3.77%	12.41%	8.64%

Table 11. Combined Federal, New York State & New York City Personal Income Tax for Married Taxpayers (2 Dependents) Filing Jointly.

		Federal Tax		New York State Tax		New York City Tax	Combined Federal, NYS & NYC Income Taxes	
		NYC	Outside NYC	NYC	Outside NYC	NYC	NYC	Outside NYC
Income		Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %	Eff. Tax Rate %
$	15,000	-47.71%	-47.71%	-14.71%	-14.71%	-2.62%	-65.04%	-62.41%
$	25,000	-27.69%	-27.69%	-7.36%	-7.36%	-0.60%	-35.65%	-35.05%
$	50,000	0.85%	0.85%	1.66%	1.66%	1.78%	4.29%	2.51%
$	75,000	5.54%	5.54%	3.20%	3.20%	2.38%	11.11%	8.73%
$	100,000	5.67%	6.04%	3.68%	3.68%	2.50%	11.85%	9.72%
$	250,000	16.96%	16.96%	5.88%	5.88%	3.09%	25.94%	22.85%
$	500,000	24.28%	24.28%	6.16%	6.16%	3.24%	33.67%	30.44%
$	1,000,000	25.89%	26.44%	6.39%	6.39%	3.48%	35.76%	32.84%
$	2,000,000	25.50%	27.14%	6.59%	6.59%	3.66%	35.75%	33.72%
$	5,000,000	28.20%	29.88%	8.64%	8.64%	3.77%	40.61%	38.52%



New York State and Local Sales and Use Tax - Representative Taxpayers

Methodology

The amount of State and local sales tax paid by each representative taxpayer was estimated using data in the Consumer Expenditure Survey (CES). The survey is published annually by the U.S. Bureau of Labor Statistics and contains information on the range of consumers' expenditures and incomes, as well as the characteristics of those consumers. The most recent survey reports 2011 expenditure information.

CES data do not suffice to directly estimate the tax paid by each of the representative taxpayers selected for this analysis. However, applying reasonable assumptions to the baseline estimates allow for an approximation of how other factors (e.g., age and single-person households) affect the tax estimates. Data limitations also require assumptions to be made about taxable spending by higher income taxpayers that are outside the scope of the CES. All estimates are adjusted for NYC/non-NYC differences in local tax bases and local tax rates.

Table 12. State and Local Sales and Use Tax by Income for a Typical Household*

Income	New York City		Outside NYC	
	State and Local Sales Tax	Tax as a % of Income	State and Local Sales Tax	Tax as a % of Income
$ 15,000	$ 840	5.60%	$ 566	3.77%
$ 25,000	$ 977	3.91%	$ 653	2.61%
$ 50,000	$ 1,583	3.17%	$ 1,090	2.18%
$ 75,000	$ 2,109	2.81%	$ 1,442	1.92%
$ 100,000	$ 2,457	2.46%	$ 1,666	1.67%
$ 250,000	$ 3,919	1.57%	$ 2,634	1.05%
$ 500,000	$ 6,591	1.32%	$ 4,430	0.89%
$ 1,000,000	$ 11,085	1.11%	$ 7,451	0.75%
$ 2,000,000	$ 18,642	0.93%	$ 12,530	0.63%
$ 5,000,000	$ 39,190	0.78%	$ 26,342	0.53%

* Two-person household with two dependents.

Discussion

Estimated New York State and local sales tax burdens by income are presented in Table 12 above. These results reflect the well-known regressive feature of the sales tax. Higher income taxpayers pay more in taxes than lower-income households, but the amount represents a significantly smaller percentage of their income compared to lower-income households. For example, a representative household in New York City with a $250,000 income pays, on average, nearly $4,000 in annual sales tax. However, this is a much smaller share of their income when compared to, say, a household earning $50,000 that pays about $1,600 in tax (1.57% vs. 3.17%).

The sales tax burden relative to income is substantially higher at every income level for a New York City taxpayer relative to the rest of New York State. A non-NYC taxpayer pays about one-third less in sales tax for a given income compared to a City taxpayer. This disparity is a consequence of the higher local sales tax rate in New York City, the City's broader local sales tax base, and a higher level of spending across all expenditure categories relative to other parts of the State.

Other Scenarios

The Consumer Expenditure Survey, which is the main source of data for these estimates, includes data that allow for an analysis of how factors such as age and number of persons in a household change the base case estimates provided in Table 12. Tables 13 and 14 present this analysis. Not unexpectedly, across all income levels, a single-person household spends less on taxable items and services (about 16% less) than does a multi-person household. A two-person household where both members are at least 65 years of age also spends less than the four-person base case, but the difference is less pronounced. In this case, the taxable spending by such a household is about 95% of the four-person household.

Table 13. State and Local Sales and Use Tax by Income for a Single Person Household

	New York City		Outside NYC	
Income	State and Local Sales Tax	Tax as a % of Income	State and Local Sales Tax	Tax as a % of Income
$ 15,000	$ 704	4.69%	$ 469	3.12%
$ 25,000	$ 818	3.27%	$ 541	2.16%
$ 50,000	$ 1,327	2.65%	$ 902	1.80%
$ 75,000	$ 1,767	2.36%	$ 1,194	1.59%
$ 100,000	$ 2,059	2.06%	$ 1,379	1.38%
$ 250,000	$ 3,284	1.31%	$ 2,181	0.87%
$ 500,000	$ 5,524	1.10%	$ 3,668	0.73%
$ 1,000,000	$ 9,290	0.93%	$ 6,169	0.62%
$ 2,000,000	$ 15,624	0.78%	$ 10,375	0.52%
$ 5,000,000	$ 32,845	0.66%	$ 21,811	0.44%

Table 14. State and Local Sales and Use Tax by Income for a Two-Person 65+ Household

	New York City		Outside NYC	
Income	State and Local Sales Tax	Tax as a % of Income	State and Local Sales Tax	Tax as a % of Income
$ 15,000	$ 793	5.29%	$ 532	3.55%
$ 25,000	$ 923	3.69%	$ 615	2.46%
$ 50,000	$ 1,496	2.99%	$ 1,025	2.05%
$ 75,000	$ 1,993	2.66%	$ 1,356	1.81%
$ 100,000	$ 2,322	2.32%	$ 1,567	1.57%
$ 250,000	$ 3,704	1.48%	$ 2,477	0.99%
$ 500,000	$ 6,229	1.25%	$ 4,166	0.83%
$ 1,000,000	$ 10,476	1.05%	$ 7,007	0.70%
$ 2,000,000	$ 17,618	0.88%	$ 11,784	0.59%
$ 5,000,000	$ 37,037	0.74%	$ 24,774	0.50%

New York's Local Real Property Tax - Representative Taxpayers

Methodology

Property tax data typically do not contain information regarding the incomes of owners, so it was necessary to utilize multiple data sets in order to make estimates by income level and region. For those taxpayers earning $250,000 or less, a special 2007 data set that contained information on income and residential property ownership was available. It had been generated when the taxpayers in question signed up for a State-funded tax rebate program associated with the School Tax Relief (STAR) property tax exemption. From this data set, average property tax liabilities were calculated for taxpayers with incomes approximating the selected income levels, and these were further grouped by economic development region. The definition of income used therein was Federal adjusted gross income, less any distributions from an IRA or other retirement annuity. All estimates were then rounded to the nearest $100. While households that rent rather than own their homes can be thought of as paying property taxes indirectly as a component of monthly rent, lack of microdata on the rent-income-taxes relationship for New York taxpayers necessarily limits the current study to residential property taxes paid by owner - occupied households. According to data from the Consumer Expenditure Survey prepared by the U. S. Bureau of Labor Statistics, households earning less than $25,000 are significantly more likely to be renters rather than homeowners, so the representative taxpayer for the $15,000 income category is thus assumed to be a renter.

To obtain estimates of the property tax liabilities of those homeowners with incomes exceeding $250,000, Department of Taxation and Finance personal income tax return files were used. Unlike the typical State income tax return, where taxpayers use the standard deduction, returns filed by taxpayers at the high income levels in question typically claim itemized deductions, thus providing information on property taxes paid. These data were also grouped by income level, using the same definition of income as outlined above, and by region, in order to develop the required estimates, which were again rounded to the nearest $100. Assignment to a region was based on the address designated by the taxpayer as their permanent address, and lack of sufficient sample sizes for the higher income categories in some regions precluded making estimates of property taxes paid. It is also worth noting that in this income category, the itemized deduction claimed for property taxes may well include taxes paid on more than one residence.

Discussion

Estimated residential property tax burdens by income and region of the State are presented in Table 15. The income levels specified are the same as those used in portraying the liabilities of representative taxpayers with respect to other taxes such as income tax and sales tax, so they are not necessarily the ones that would be chosen for a portrayal of property tax liability alone. Estimates are thus provided for those incomes/regions where sufficient observations were available to generate reliable results.

The estimates indicate some trends that might well be expected and others that may be surprising to some. First, property taxes paid rise with income level. However, they rise less than proportionately with income, with the result that for lower income levels property taxes are a substantially higher percentage of income than for higher income levels (see Table 16). These findings demonstrate the regressive nature of the tax, at least with respect to residential property.

Significant differences in tax burden exist among the State's regions, even when income is held constant. Taxpayers of the same income levels pay substantially more taxes in the State's more urban and suburban Mid-Hudson and Long Island regions, and to a lesser extent in the Capital District region, than in the more rural areas of the State. New York City is a major exception to this trend, with residential taxpayers there paying significantly lower taxes (generally one-half to two-thirds as much) compared to taxpayers having the same incomes but residing in the neighboring Mid-Hudson and Long Island regions. New York City's relatively low property tax burden is mitigated by other City taxes imposed on its residents, including its personal income tax, that are not imposed statewide.

Tax burdens in the regions of the State that lie north or west of the Capital District and Mid-Hudson corridor generally have the lowest tax burdens outside New York City. These areas also tend to have lower average prices for residential real estate, with some notable exceptions, in particular communities where there is demand for recreation-oriented property, especially waterfront development.

Table 15. Typical Residential Property Tax Bill by Income and Region*

	---------------------------Economic Development Council Region-----------------------									
	Western NY	Finger Lakes	So. Tier	Central NY	Mohawk Valley	North Country	Capital Region	Mid-Hudson	NYC	LI
Income*										
$15,000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
$25,000	$2,300	$2,700	$2,100	$2,500	$2,100	$1,700	$3,200	$5,900	$2,200	$7,100
$50,000	$2,800	$3,200	$2,500	$3,000	$2,400	$2,100	$3,600	$6,034	$2,300	$7,200
$75,000	$3,400	$3,900	$3,100	$3,700	$2,900	$2,600	$4,200	$6,700	$2,600	$7,500
$100,000	$4,100	$4,800	$4,000	$4,600	$3,600	$3,300	$4,900	$7,600	$2,900	$7,900
$250,000	$7,400	$8,800	$8,100	$8,300	$6,200	$6,300	$8,000	$13,100	$5,300	$11,400
$500,000	$14,900	$17,600	$15,900	$16,900	$16,200	$12,100	$15,200	$23,900	$13,700	$21,000
$1,000,000	$20,200	$28,600	$18,700	$22,300	N/A	N/A	$25,000	$33,200	$20,800	$29,300
$2,000,000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	$48,000	$32,500	$42,700
$5,000,000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	$67,300	$52,900	$56,100
* defined as federal adjusted gross income, less any IRA and retirement annuity distrib.										

Table 16. Typical Residential Property Tax Bill as a Percent of Income, by Region*

	---------------------------Economic Development Council Region-----------------------									
	Western NY	Finger Lakes	So. Tier	Central NY	Mohawk Valley	North Country	Capital Region	Mid-Hudson	NYC	LI
Income*										
$15,000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
$25,000	9.2	10.8	8.4	10.0	8.4	6.8	12.8	23.6	8.8	28.4
$50,000	5.6	6.4	5.0	6.0	4.8	4.2	7.2	12.1	4.6	14.4
$75,000	4.5	5.2	4.1	4.9	3.9	3.5	5.6	8.9	3.5	10.0
$100,000	4.1	4.8	4.0	4.6	3.6	3.3	4.9	7.6	2.9	7.9
$250,000	3.0	3.5	3.2	3.3	2.5	2.5	3.2	5.2	2.1	4.6
$500,000	3.0	3.5	3.2	3.4	3.2	2.4	3.0	4.8	2.7	4.2
$1,000,000	2.0	2.9	1.9	2.2	N/A	N/A	2.5	3.3	2.1	2.9
$2,000,000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2.4	1.6	2.1
$5,000,000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.3	1.1	1.1
* defined as federal adjusted gross income, less any IRA and retirement annuity distrib.										

Combined Tax Burdens

Tables 17 and 18 provide an example of the overall tax burden across various income brackets for a typical household in New York State (outside of New York City) and in New York City, respectively. A typical household is defined as a married couple with two dependents. While the income definition in the analysis varies among taxes, for ease of comparison it is assumed they correspond to one another.

Table 17. Total Tax Burden by Income for a Typical Household 1/

Outside New York City							
Income 2/	Percent of Income						
	Personal Income Tax		State and Local Sales Tax	Real Property Tax /3	TOTAL (Including Federal)	TOTAL State and Local
	Federal	New York State				
$ 15,000	-47.7%	-14.7%	3.8%	N/A	-58.7%	-10.9%
$ 25,000	-27.7%	-7.4%	2.6%	13.4%	-19.0%	8.7%
$ 50,000	0.9%	1.7%	2.2%	7.8%	12.5%	11.6%
$ 75,000	5.5%	3.2%	1.9%	6.6%	17.3%	11.7%
$ 100,000	6.0%	3.7%	1.7%	6.1%	17.5%	11.5%
$ 250,000	17.0%	5.9%	1.1%	4.7%	28.6%	11.6%
$ 500,000	24.3%	6.2%	0.9%	4.3%	35.6%	11.4%
$ 1,000,000	26.4%	6.4%	0.8%	3.1%	36.7%	10.2%
$ 2,000,000	27.1%	6.6%	0.6%	2.2%	36.6%	9.4%
$ 5,000,000	29.9%	8.6%	0.5%	1.2%	40.3%	10.4%

1/ Two-person household with two dependents

2/ Defined as total Federal Adjusted Gross Income (FAGI) for Personal Income Tax purposes; FAGI, less any IRA and retirement annuity distributions for Real Property Tax purposes; and the total money earnings of a household as defined by the Consumer Expenditure Survey for State and Local Sales Tax purposes.

3/ Results are for all Economic Development Council Regions outside New York City.

Table 18. Total Tax Burden by Income for a Typical Household 1/

New York City							
	Percent of Income						
Income 2/	Personal Income Tax			State and Local Sales Tax	Real Property Tax 3/	TOTAL	TOTAL minus Federal Personal Income Tax
	Federal	New York State	New York City				
$ 15,000	-47.7%	-14.7%	-2.6%	5.6%	N/A	-59.4%	-11.7%
$ 25,000	-27.7%	-7.4%	-0.6%	3.9%	8.8%	-22.9%	4.8%
$ 50,000	0.9%	1.7%	1.8%	3.2%	4.6%	12.1%	11.2%
$ 75,000	5.5%	3.2%	2.4%	2.8%	3.5%	17.4%	11.9%
$ 100,000	5.7%	3.7%	2.5%	2.5%	2.9%	17.2%	11.5%
$ 250,000	17.0%	5.9%	3.1%	1.6%	2.1%	29.6%	12.6%
$ 500,000	24.3%	6.2%	3.2%	1.3%	2.7%	37.7%	13.4%
$ 1,000,000	25.9%	6.4%	3.5%	1.1%	2.1%	39.0%	13.1%
$ 2,000,000	25.5%	6.6%	3.7%	0.9%	1.6%	38.3%	12.8%
$ 5,000,000	28.2%	8.6%	3.8%	0.8%	1.1%	42.5%	14.3%

1/ Two-person household with two dependents

2/ Defined as total Federal Adjusted Gross Income (FAGI) for Personal Income Tax purposes; FAGI, less any IRA and retirement annuity distributions for Real Property Tax purposes; and the total money earnings of a household as defined by the Consumer Expenditure Survey for State and Local Sales Tax purposes.

3/ Results are for the New York City Economic Development Council Region

Table 17 shows the combined tax burden for married couples with two dependents who live outside New York City. The Total column (second from right) includes the Federal income tax, which drives the clearly progressive structure, with effective rates ranging from -58.7 percent to 40.3 percent. The story is much different when looking at just State and local taxes in the column (far right). Here, the incidence of these combined taxes is slightly regressive, with effective rates declining over most of the income ranges. The regressive effect of the property tax and sales tax is outweighing the progressivity of the State income tax. This result is consistent with other New York incidence studies.

Table 18 shows corresponding results for married taxpayers with two dependents who live in New York City. Again, the Total column demonstrates the highly progressive nature of the Federal income tax. However, the State and Local column, as compared to Table 17, shows a more proportional, if not slightly progressive result for City residents. This outcome is driven by the fact that the City places reduced reliance on the regressive property tax, replacing it in part with its progressive income tax.

Figure 2 below illustrates the combined effective rates for State and local taxes only, for residents who live within and without New York City.

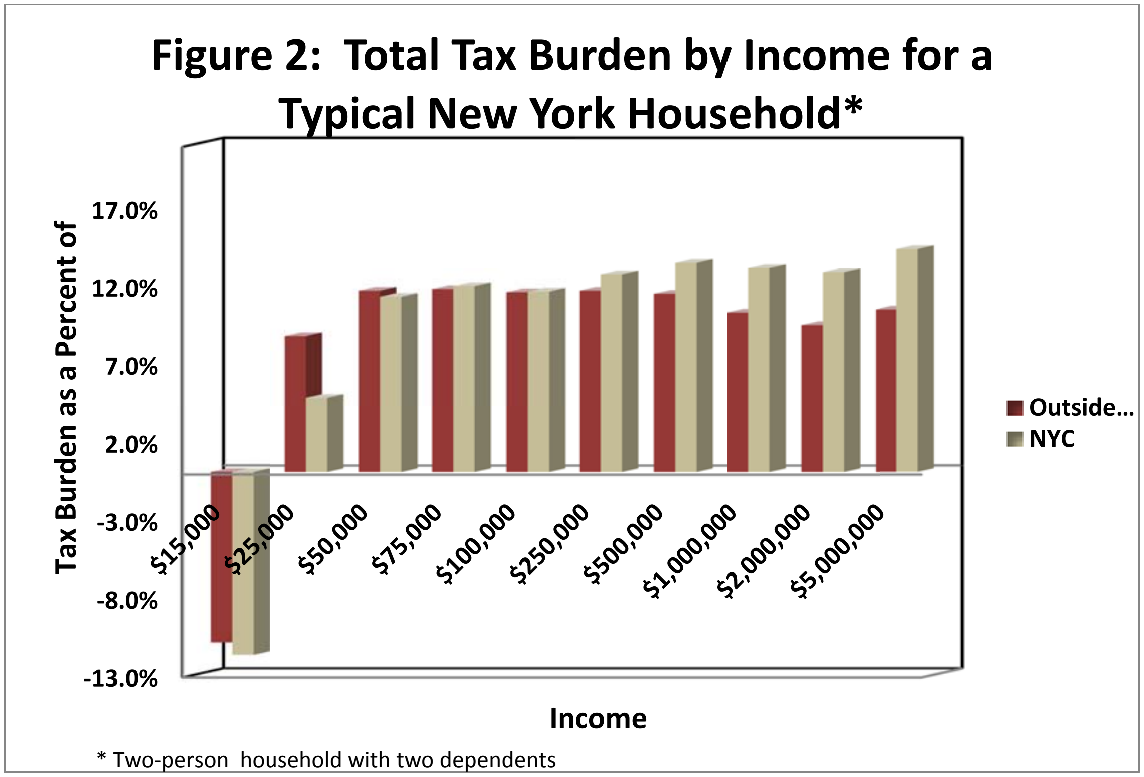


Table 19 shows the combined New York City income tax, sales tax (local share only) and property tax burden for City residents. Here, the incidence of these combined taxes is noticeably regressive, with effective rates declining over most of the income ranges. The regressive effect of the property tax and sales tax outweighs the progressivity of the City income tax.

Table 19. New York City Total Tax Burden by Income for a Typical Household 1/

New York City				
Income 2/	Percent of Income			
	Personal Income Tax	Local Sales Tax	Real Property Tax 3/	TOTAL
$ 15,000	-2.6%	3.0%	N/A	0.4%
$ 25,000	-0.6%	2.1%	8.8%	10.3%
$ 50,000	1.8%	1.7%	4.6%	8.1%
$ 75,000	2.4%	1.5%	3.5%	7.4%
$ 100,000	2.5%	1.3%	2.9%	6.7%
$ 250,000	3.1%	0.8%	2.1%	6.0%
$ 500,000	3.2%	0.7%	2.7%	6.6%
$ 1,000,000	3.5%	0.6%	2.1%	6.2%
$ 2,000,000	3.7%	0.5%	1.6%	5.8%
$ 5,000,000	3.8%	0.4%	1.1%	5.3%

1/ Two-person household with two dependents

2/ Defined as total Federal Adjusted Gross Income (FAGI) for Personal Income Tax purposes; FAGI, less any IRA and retirement annuity distributions for Real Property Tax purposes; and the total money earnings of a household as defined by the Consumer Expenditure Survey for State and Local Sales Tax purposes.

3/ Results are for the New York City Economic Development Council Region

BUSINESS TAX BURDEN IN NEW YORK STATE

Prepared for the New York State Tax Reform and Fairness Commission

April 2013

In the State fiscal year ending in March 2012 (SFY 2011-12), the New York State Department of Taxation and Finance collected $61.4 billion in various State taxes and $25.1 billion in local taxes[1]. In addition, local governments with fiscal years ending in 2012 collected approximately $49 billion in real property taxes[2]. This represents over $135 billion of taxes imposed on New York State (including New York City) taxpayers. In addition, New York City administered and collected $6.4 billion from corporations and unincorporated businesses operating within its boundaries.

This report will analyze the business tax burden in four major tax areas: personal income tax, sales tax, property tax, and business income taxes. Smaller miscellaneous taxes are assumed to be primarily borne by individuals.

The share of State and local taxes borne by business is set out below.

- For State and local fiscal years ending in 2012, business paid approximately $48.9 billion in taxes out of a total of $141.9 billion (34.5 percent).
- Over one-third (37 percent) of the State and local sales tax burden is borne by business.
- Nearly 38 percent of the property tax burden is borne by business.

The tables below summarize these results.

2011-12 State & Local Business Tax Burden ($ in billions)			
Tax Type	Total Collections[1]	Business Source[2]	% Business
Income Tax	$46.9	$7.1	15.1%
Sales Tax	24.9	9.2	37.0%
Property Tax	49.0	18.5	37.8%
Business Taxes	14.9	14.1[2]	94.6%
Other Taxes	6.2	0.0	0%
Total	$141.9	$48.9	34.5%
[1]Numbers are rounded			
[2]Includes MCTD taxes and surcharges, but excludes excise/gross receipts taxes			

Percent Share of Business Tax Burden	
Tax Type	Percent Share
Income Tax	14.5%
Sales Tax	18.9%
Property Tax	37.8%
Business Taxes	28.8%
Other Taxes	0.0%
Total	100.0%

[1] Does not include the fully rebated stock transfer tax.
[2] Net of STAR for the school tax portion.

Personal Income Tax

Businesses pay tax under the personal income tax if the business is organized as a sole proprietorship, a partnership or limited liability partnership, or a subchapter S corporation. Business income is reported either on Schedule C (Profit or Loss from Business – Sole Proprietorship) or Schedule E (Supplemental income and loss from rental real estate, royalties, partnerships, S corporations, estates and trusts). A tax simulation model coupled with tax return data from 2010 was used to estimate the income tax paid by businesses. After an adjustment for removing income from rents, royalties, estate and trusts, it was estimated that 15.3 percent of the income tax comes from business sources. A similar analysis was performed on the New York City income tax with nearly identical results.

In 2011-12, the personal income tax generated $38.8 billion for the State and $8.1 billion for New York City. Using the ratio noted above, approximately $5.9 billion of the State personal income tax and $1.2 billion of the City personal income tax came from business sources.

Sales Tax

The sales tax is imposed on sales of tangible personal property unless specifically exempted from tax, and on various enumerated services. New York's sales tax does not apply to goods or services that are purchased for resale. The resale exemption encompasses the purchase of finished goods for resale, the purchase of raw materials used to produce other goods, and the purchase of property transferred to a customer in the course of providing a taxable service (e.g., the purchase of motor oil used to provide an oil change service). New York also provides generous exemptions to manufacturers, farms, and utility companies for the machinery, equipment, and energy used in their production processes. Notwithstanding these exemptions and others (e.g. exemptions for film production, race horses, Internet data centers, etc.), New York's sales tax applies to a wide range of business purchases. Notably, the sales tax does not exempt the machinery, equipment, parts, tools, and supplies used by most service providers.

In a case study developed for the 2010-11 Annual Tax Expenditure Report, the Division of the Budget estimated that 42 percent of New York State's sales tax is paid by businesses and nonresidents. The Tax Department estimates that the percentage paid by business alone is 37 percent. For State fiscal year 2011-12, this would mean that businesses paid about $4.1 billion in State sales tax on approximately $100 billion in taxable purchases. The local sales tax generates more revenue than the State tax with the result that another $5.1 billion of the local sales tax comes from business purchases. Another recent study, conducted by Ernst & Young and the Council on State Taxation using a different methodology, concluded that the share of New York sales tax paid by business could be as high as 52 percent.

Property Tax

The real property tax is levied on both residential and business properties throughout the State. The estimates of property taxes paid by different property use categories are based on 2011 assessment rolls and taxes levied in local fiscal years ending in 2012. A detailed analysis of liability by property use category for school taxes was used in this analysis. This information is prepared annually as an ingredient to negotiations on State aid to school districts. The shares based on school tax liabilities were then applied to the total 2012 property tax levies to estimate the total property taxes paid by each of the four types of property classifications shown in the table below.

	All of NYS, including NYC		NYC Only		All of NYS except NYC	
	Levy ($b)	% Levy	Levy ($b)	% Levy	Levy ($b)	% Levy
Residential	$28.6	58.4%	$9.6	52.4%	$19.0	61.9%
Commercial/Industrial	$15.1	30.8%	$6.9	37.4%	$8.2	26.9%
Utility	$3.4	6.9%	$1.7	9.2%	$1.7	5.6%
Other	$1.9	3.9%	$0.2	1.0%	$1.7	5.6%
Total	$49.0	100.0%	$18.3	100.0%	$30.7	100.0%

For NYC, residential consists of classes 1 and 2. Other includes vacant land and cultural/recreation.
For NYS, other includes minor revenue share categories: agriculture, forest land, vacant land, recreation, community service.

The table shows that statewide $18.5 billion, or 37.8 percent of the property tax levy, is imposed on businesses (commercial, industrial, and utilities).

Corporate Taxes

Incorporated entities are subject to corporate State-level taxation under one of several industry-specific tax articles. Most businesses file under Article 9-A, the general corporate franchise tax. This includes S corporations, which pay a fixed minimum tax based on New York receipts, but whose income, loss, gains, deductions and credits flow through to the shareholder level where it is taxed under the personal income tax. Banks file under Article 32 and insurance companies file under Article 33. Utility, telecommunication, transportation and transmission, and agricultural co-operative businesses pay a franchise tax under Article 9 that consists of a capital value base component and an excise tax component. Article 9 also imposes initial taxes and annual fees on domestic and foreign corporations.

The table below contains the business tax collections for the 2011-12 State fiscal year. The petroleum business tax was not included because it is assumed that it operates like the motor fuel tax and is borne predominantly by consumers of gasoline. Similarly, collections from several sections of Article 9 that are based on gross receipts are also excluded under the same assumption that their cost is passed through to the ultimate consumer. They include the Section 184 additional franchise tax on transportation and transmission companies, the Section 186 franchise tax on utilities[3], the Section 186-a gross receipts tax on utilities, and the 186-e excise tax on telecommunications services. It should also be noted that collections in any one fiscal year are comprised of amounts from multiple tax years. This is because many taxpayers must make estimated payments throughout the year in addition to any final tax year liability. The amounts also include audit settlements that may cover several tax periods. New York City also administers its own taxes on corporations, banks, utilities, and unincorporated businesses.

[3] Section 186 was repealed effective January 1, 2000 but companies may elect to remain taxable under certain circumstances. In 2009, the most recent year for which tax return data are available, there were 23 "continuing Section 186 taxpayers." The election is available for utilities primarily engaged in co-generation, subject to tax under Section 186 but not 186-a for tax years ending on December 31, 1999, and a party to a total output contract as of January 1, 2000.

In addition, the State collected another $2.5 billion in business taxes for the downstate Metropolitan Commuter Transportation District (MCTD) in business tax surcharges, mobility tax, auto rental tax, and medallion taxi ride tax.

Business Tax Article	SFY11-12 State Collections in Billions	FY12 NYC Collections in Billions
Corporate Franchise Tax (9-A)	$2.7	$2.8
Bank Tax (32)	$1.2	$1.4
Insurance Tax (33)	$1.2	n.a.
Corporation and Utilities Tax (9)	$0.05	$0.4
Unincorporated Business Tax		$1.7
Total	$5.2	$6.4
Total State and City Collections in Billions		$11.6
Total MCTD Business Tax Surcharges in Billions		$2.5
Total Business Tax Collections in Billions		$14.1

AN EVALUATION OF NEW YORK STATE'S SALES AND COMPENSATING USE TAX

Prepared for the New York State Tax Reform and Fairness Commission

June 2013

I. Background

A. *Overview of Current New York State Structure*

New York adopted a State and local sales and compensating use tax (sales tax) in 1965 under Articles 28 and 29 of the Tax Law.

New York's sales tax is a retail tax imposed on consumers. Vendors (businesses who make retail sales) collect the tax as agents of the State. Liability for the tax rests with the purchaser and as a rule vendors must state the amount of tax separately from the price on any receipt given to their customers. However, vendors and their responsible officers are personally responsible for paying the tax if they fail to collect or remit the correct amount.

New York's sales tax is a "destination tax." The location where the vendor delivers the product or service to the purchaser determines the location of the sale and the appropriate local tax rate.

The compensating use tax is imposed as a complement to the sales tax. New York residents owe this tax, for example, when they make a purchase in another state and bring the taxable item into New York.[1]

1. Tax Base

The sales tax applies to retail sales of:

- tangible personal property, or physical goods (presumed taxable unless specifically exempt);
- certain gas, electricity, refrigeration and steam and telephone service;
- selected services (services are presumed exempt unless specifically enumerated);
- food and drink sold by restaurants, taverns and caterers;
- hotel occupancy; and
- certain admission charges and dues.

2. Tax Rates

The general State sales tax rate is 4 percent. Additional State sales tax rates or special rules regarding rates apply in some instances.[2]

3. Tax Exemptions

A transaction can be exempt from the sales tax because:

- the property or service is exempt;
- the specific use of the property or service is exempt; or
- the purchaser or seller is an exempt entity.

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[1] A credit against the amount of use tax owing is generally available for sales tax paid to another state.

[2] An additional 0.375 percent State rate applies in the Metropolitan Commuter Transportation District (MCTD); a fixed rate of 8 cents-per-gallon (8.75 cents-per gallon in the MCTD) applies to gasoline and highway use of diesel motor fuel; an additional 6 percent (additional 11 percent in the MCTD) is levied on passenger car rentals; an additional 5 percent rate is imposed on telephone information/entertainment services that are exclusively delivered "aurally"; and, an additional "convention center hotel unit fee" of $1.50 per room per day applies in NYC.

Exempt transactions include:

- Selected tangible personal property such as:
  - most food items (other than soda, candy, etc.) for at-home consumption;
  - clothing priced under $110;
  - prescription and non-prescription drugs;
  - newspapers and periodicals;
  - flags of the United States and New York;
  - certain items sold through vending machines; and
  - water delivered through mains and pipes.
- Selected utilities:
  - interstate telephone services;
  - residential energy; and
  - separately purchased energy transmission and distribution service.
- Selected services and admissions:
  - capital improvements to real property;
  - cable television;
  - advertising services;
  - transportation services in connection with funerals;
  - certain parking services at a private residence; and
  - Many admission charges including admissions to movie theaters, participatory sporting activities (e.g., golf, skiing, and bowling), dramatic or musical arts performances, and live circus performances.
- Purchases and certain sales by exempt entities:
  - certified exempt organizations or government entities including not-for-profit religious, charitable and educational organizations and New York State and its political subdivisions; and
  - other exempt organizations including federal agencies, diplomats, Indian nations, the United Nations, certain credit unions, rural electric cooperatives, and nonprofit health maintenance organizations.
- Exempt uses – businesses expenditures:
  - purchases for resale;
  - a manufacturer's purchase of machinery and equipment used to produce tangible personal property for sale;
  - items used in farm production or commercial horse boarding;
  - commercial aircraft and commercial vessels;
  - trash removal from a waste transfer facility;
  - fuel sold to airlines;
  - ferry boats; and
  - telephone service used by the media.

The *Annual Tax Expenditure Report* published jointly by the Department of Taxation and Finance and the Division of the Budget catalogs and estimates 150 tax exemptions, credits, and other special tax benefits. Some of largest categories include sales tax exemptions provided to households for food, medicine, and clothing.

Table 1. Significant NYS Sales Tax Consumer Exemptions Estimated for 2013 ($ in millions)

Exemption	Value
Food Items	$ 1,313
Prescription and Non-prescription Drugs and Medical Supplies	$ 1,056
Clothing Priced Under $110	$ 833
Residential Energy	$ 763
Gasoline Cap at $2/gallon	$ 384
Cable Television Services	$ 305

In addition to sales tax exemptions provided for households, numerous sales tax exemptions are provided to businesses, organizations, and State and local governments.

Table 2. Significant NYS Sales Tax Business Exemptions Estimated for 2013 ($ in millions)

Exemption	Value
New York State and Local Governments	$ 1,299
Charitable Organizations	$ 528
Machinery or Equipment Used in Production	$ 296
Fuel, Gas, Electricity, Refrigeration and Steam Used in Research & Development and Production	$ 178
Farm Production and Commercial Horse Boarding	$ 80
Telecommunications and Internet Equipment	$ 76
Research and Development Property	$ 65

In some circumstances a transaction is not taxed because the product is not explicitly included within the tax. Sales of digital products are not subject to tax because they are not tangible personal property.[3]

4. Contribution to State Tax Revenue

New York raises over $11 billion annually from its State sales tax. The tax accounts for about 18 percent of State tax collections.

[3] Digitally transferred or accessed software, however, is included in the statutory sales tax imposition on "tangible personal property" and thus taxable.

B. Local Sales Taxes

1. Local Tax Base

Cities and counties have two options when imposing local sales tax:

- conform to the State sales tax base while electing "local options" with respect to:
  - clothing and footwear priced under $110;
  - residential energy;
  - residential and commercial solar energy systems; and
  - the calculation of tax on gasoline and diesel fuel.
- impose tax only on selected components of the sales tax base (an option employed by just four cities). These components are:
  - utility services;
  - restaurant food and drink;
  - hotel room occupancy; and
  - certain amusement charges.

New York City has unique authorization to impose its tax on a broader range of services than the State or other local governments. These services include those provided by beauty salons, barber shops, health salons, gymnasiums, saunas, and credit rating agencies.[4]

School districts that are partly or wholly within cities with populations under 125,000 may impose a sales tax of up to 3 percent on utility services, including residential and non-residential electricity, gas service, and telephone service.

2. Local Tax Rates

Counties, cities, and certain school districts are authorized to impose a local sales tax in one-half percent increments, up to a maximum of 3 percent. Towns and villages may not impose a sales tax, although they often share in the distribution of county sales tax proceeds.

All counties and 20 cities impose a local sales tax. Of these localities, six cities (including New York City) and all but six counties have received legislative authority to impose tax at additional rates above the 3 percent maximum, ranging from 3.5 percent to 4.75 percent.

Over 90 percent of the State's population resides in an area where the combined State and local sales tax rate equals or exceeds 8 percent. Figure 1 illustrates the variation in combined State and local sales tax rates across the state.

3. Contribution to Local Tax Revenue

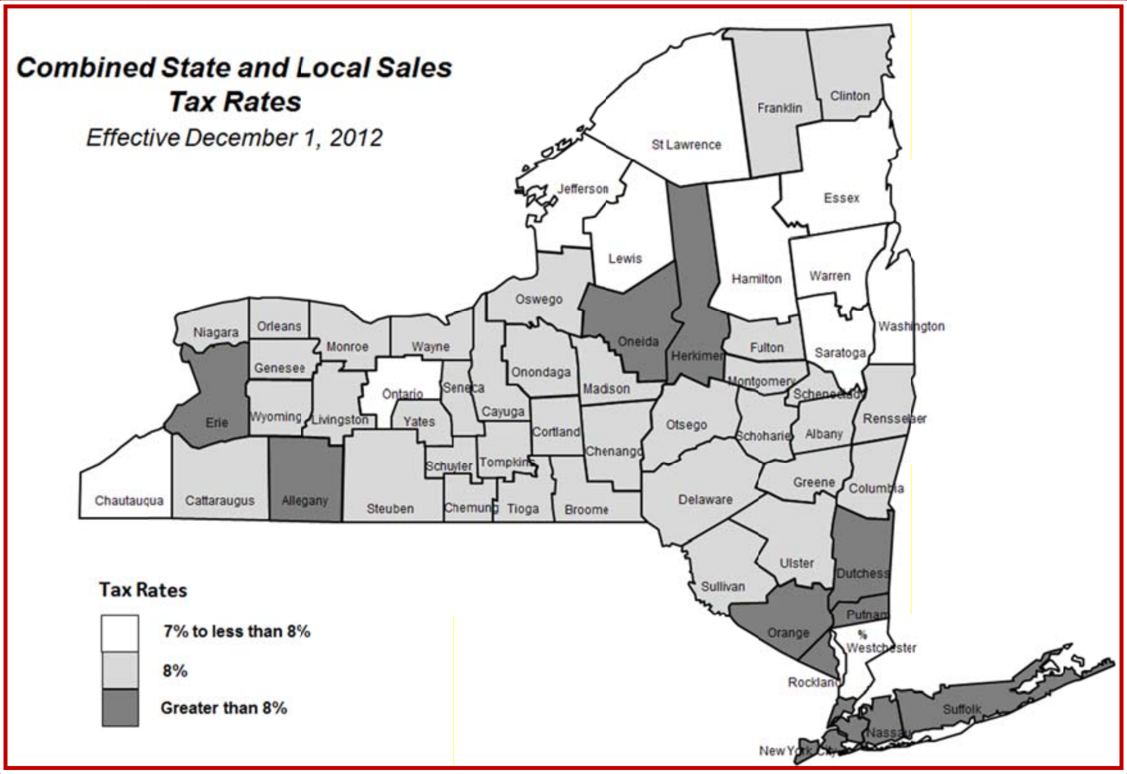
Local governments (counties, cities, and certain School Districts) raise about $14 billion annually from the sales tax. Local government reliance on the sales tax as a revenue source varies.

- For counties, the sales tax is the largest single revenue source accounting for over 32 percent of total revenues for all counties;
- New York City receives nearly 10 percent of its revenue from the sales tax; and

[4] New York City also: uses a different definition of the term "permanent resident" in a tax exemption relating to hotel occupancy; taxes certain fuels used in the production of electricity and gas; taxes some sales of electric and gas transmission and distribution that are not taxed elsewhere in the State; and exempts interior decorating and design services that are taxed by the State and every other locality.

- Other cities (outside of New York City) receive about 19 percent of their revenue from the sales tax.[5]

Figure 1. New York State and Local Sales Tax Rates by County



C. Tax Administration

1. Registration

Vendors must register with the Tax Department before starting business. Currently about 550,000 businesses are registered with the Department as sales tax vendors. They may register online.

2. Filing Requirements

The sales tax is a quarterly tax. However, a vendor must file monthly if it has more than $300,000 in taxable sales and purchases during a quarter. The monthly payments are reconciled with the vendor's quarterly return.   Vendors collecting less than $3,000 in sales tax yearly may elect to file annually. Sales tax returns must be filed within twenty days of the end of the monthly, quarterly, or annual period.

Roughly 65 percent of sales tax revenue is collected by the largest one percent of vendors (approximately 6,000), who are required to participate in the "PrompTax" program.

[5] Office of the New York State Comptroller, *2012 Annual Report.*

PrompTax applies to vendors with an annual tax liability exceeding $500,000. This is a statutory program that accelerates tax payments from participating vendors.[6]

Table 3. Vendor Profile by Tax Return Filing Status			
Filing Status	Number of Active Vendors	Percent of Total Vendors	Percent of State and Local Receipts*
PrompTax	5,988	1.1%	65.1%
Monthly	37,668	6.8%	23.0%
Quarterly	240,590	43.7%	11.4%
Annual	266,537	48.4%	0.5%
Total	550,783	100.0%	100.0%
* Selling Period March 1, 2010 through February 28, 2011			
Source: *New York State Department of Taxation and Finance, Office of Tax Policy Analysis*			

Approximately 80 percent of returns are filed and paid electronically using Sales Tax Web File.

Special prepayment provisions apply to collecting the sales tax on motor fuel and cigarettes.[7]

3. Tax Compliance

With 550,000 sales tax vendors, reliance on voluntary compliance is a critical factor in sales tax administration. The majority of sales tax revenue– approximately 94 percent– is collected through voluntary compliance. The Department engages in a wide range of activities that promote compliance, including:

- publishing sales tax forms, instructions and guidance;
- assisting and educating vendors (e.g., the sales tax telephone call center); and
- conducting audits and engaging in criminal enforcement as necessary.

Businesses required to collect and remit the tax face costs of compliance to meet their responsibilities. For example, costs are associated with:

- preparing tax returns;
- documenting tax-exempt sales;
- training personnel on sales tax issues;
- providing customer service related to sales tax issues;
- programming and servicing point-of-sale equipment;
- conducting sales tax research; and
- handling audits and appeals.

[6] The payment schedule requires PrompTax vendors to pay tax for the first 22 days of a month within three business days of that date by ACH credit, ACH debit or certified check. The balance of tax due for the preceding month is also included in this payment. Tax amounts that were paid through PrompTax are reconciled each quarter on the vendor's quarterly return.

[7] The sales tax on gasoline is remitted by the first importer of the fuel into New York. This pre-payment is fixed at 14 cents per gallon (14.75 cents in the MCTD). Approximately 750 fuel distributors prepay the sales tax. A portion of the sales tax on cigarettes is prepaid by licensed cigarette agents at the same time as payment for cigarette excise tax stamps. The pre-paid rate is currently 80 cents per pack of twenty. Approximately 20,000 cigarette retailers in the State prepay the sales tax.

A 2006 study on national retail sales tax compliance costs found that nationally the average compliance cost for retailers was 3.09 percent of sales tax collected.[8] The share for small firms was 13.5 percent and the share for large firms 2.2 percent. New York offers smaller vendors (quarterly and annual filers) a collection credit of 5 percent of the tax collected, up to $200 per return, to partially offset these costs.

D. Sales Tax History

Legislation passed with the 1965-66 State Budget imposed a statewide 2 percent sales and use tax. The impetus for the tax was to fund the expansion of State services provided in the early 1960s. Governor Rockefeller deemed the imposition of a new broad-based sales tax preferable to an increase in the State's personal income tax.[9]

The tax structure was based on previously imposed local taxes. The law provided that these local taxes be jointly administered by the State. It also required the local taxes to follow the State tax structure (with some exceptions) to minimize inter-locality differences.[10]

Today, the general framework of the tax remains largely similar to the law enacted in 1965. Nonetheless, many changes to the tax rates, base, and administration have occurred over the past 48 years. Not only State and local legislative action but also federal legislation and judicial decisions have been responsible for these changes.

1. The Growth of Exemptions

The most common amendments to the sales tax law have provided new exemptions, refunds and credits. Of the 150 such provisions identified in the Tax Expenditure report, only 44 were part of the tax at the time of its enactment. Twelve were added in the remainder of the 1960s through the 1970s. The most active decade for the enactment of new expenditure items was in the 2000 to 2010 period, when 36 were created.

Base Expansion

The most significant base expansion occurred in the early 1990s, when tax was imposed on a number of additional services and on prewritten computer software. However, revenue was also raised at points in the 1990s and 2000s by using administrative procedures.[11]

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[8] The study was conducted by PricewaterhouseCoopers LLP, on behalf of the Streamlined Sales Tax Project.

[9] Staff Report to the New York State Senate Select Committee on Budget and Tax Reform, *Enhancing New York State's Fiscal Stability through a More Rational and Streamlined Sales Tax System*, July 2010, p. 4.

[10] New York City imposed the State's first local retail sales tax in 1934. In 1947, Erie County imposed a sales and use tax. By 1964, 13 counties and cities (including New York City) imposed a locally administered general sales tax.

[11] These include decreases in the PrompTax participation threshold, the acceleration of tax on leased vehicles, compliance provisions enacted in recent years and measures that increased the number of remote vendors that collect sales tax.

2. Local Sales Tax Trends Since 1965

Counties and cities with a sales tax

The number of counties and cities with a sales tax grew rapidly after 1965. By 1970, 56 localities imposed a general sales tax. Fourteen new localities added a sales tax in the 1970s and 18 more in the 1980s.[12]

Requesting authority to impose a higher rate

In the 1980s, localities began to request and receive authority from the State legislature to impose tax at a rate higher than the 3 percent maximum. These additional rates were generally authorized for a two-year period with the option for the legislature to extend the period upon its expiration.

Today, 51 counties and 6 cities have authority to impose an additional rate. Counties that still impose a 3 percent rate include Hamilton, St. Lawrence, Saratoga, Warren, Washington and Westchester (outside the four cities in the County that impose tax).

Tax base and exceptions

The local sales tax base generally mirrors the State sales tax base. However, the number of exceptions to this rule has increased over time. It has become common for the Legislature to allow localities the option of electing to follow the State in granting an exemption from tax. Examples include residential energy, clothing and footwear, residential and commercial solar energy systems, and the ability to "cap" the tax on motor fuels.

Selective sales taxes

The State sales tax enactment also incorporated a pre-existing tax authorized to be imposed by small city school districts of up to 3 percent on certain residential and non-residential energy and telephone services. Qualifying school districts have increasingly exercised their authority to impose this tax. In 1985, 13 school districts imposed the tax. Seven more impositions were added by 2000. Today, 24 school districts impose the consumer utility tax.[13]

3. Other Sales Tax Influences

The discussion above is limited to legislative action taken by the State and its localities to intentionally alter the sales tax base, rate, or method of administration. However, factors other than legislative action also impact the base.

For example, Federal court decisions based on Supreme Court Commerce Clause and Due Process doctrine can determine whether an out-of-state seller can be required to collect tax for the State.[14]

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[12] The last county to impose a sales tax was Oswego County in 1997. The most recent city to impose tax was Saratoga Springs in 2002.

[13] Another local authorization from the 1940s grandfathered into the State sales tax is the option for localities to impose a "segmented" tax on specified services instead of the general sales tax. This option has not gained popularity– only four cities impose a segmented tax.

[14] See, for example, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)

In addition the U.S. Congress has acted to prohibit the states from taxing certain goods or services:

- Since 1977, states must exempt items purchased with food stamps in order to participate in the federal food stamp program;[15]
- The Internet Tax Freedom Act prohibits states from imposing tax on Internet access services and from imposing multiple or discriminatory taxes on electronic commerce;[16]
- The Mobile Telecommunications Sourcing Act determines the sourcing rules for such services;[17]
- Federal law forbids localities from imposing tax on direct-to-home satellite services;[18] and
- Several other examples of Federal preemption of state and local tax autonomy exist and others are under consideration in the current Congress.[19]

E. Sales Tax Interstate Comparisons

Today, 45 states and the District of Columbia impose a general sales tax.[20] New York's tax differs from other states across a number of parameters ranging from the sales tax structure, base, rate, and administration to the tax's contribution to State revenue.

1. Tax structure

While New York imposes its retail sales tax on consumers, many other states impose the tax on the vendor for the "privilege of doing business" in that state. States that legally impose the tax on the vendor do not require the tax to be passed on to consumers, nor is it prohibited. Several other states impose a hybrid sales tax where they impose the tax on the vendors, but require them to shift the tax to consumers.

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[15] Food Stamp Act of 1977.
[16] Pub. L. 105-277
[17] Pub. L. 106-252
[18] 47 U.S.C. § 251 (2006).
[19] A thorough discussion of the issue is in Testimony of Walter Hellerstein before the U.S. Senate Finance Committee, April 25, 2012. http://www.finance.senate.gov/imo/media/doc/Testimony%20of%20Hellerstein.pdf
[20] The general sales tax only became a popular source of state revenue in the 1930s as states tried to recoup revenue losses resulting from the Great Depression. Mississippi became the first to impose the tax in 1932 - followed by 23 other states throughout the 1930s. In the post-war era, an additional 22 states imposed the sales tax. New York was one of the last States to impose the tax.

Table 4. States with Consumer, Vendor, or Hybrid Taxes

Consumer Taxes	Vendor Taxes	Hybrid Taxes
Idaho	Arizona	Alabama
Iowa	California	Arkansas
Louisiana	Connecticut	Colorado
Maryland	Hawaii	Florida
Mississippi	Kentucky	Georgia
Missouri	Michigan	Illinois
Nebraska	Nevada	Indiana
New York	New Mexico	Kansas
North Carolina	North Dakota	Maine
Ohio	South Carolina	Massachusetts
Pennsylvania	South Dakota	Minnesota
Rhode Island	Tennessee	New Jersey
Utah	Wisconsin	Oklahoma
Vermont		Texas
Washington		Virginia
West Virginia		
Wyoming		

In New York, as in most other States, the sales tax is a destination tax. However, a small number of states have an origin-based sales tax. In those states, the location of the sale is determined by where the taxable good is sold or shipped from, not by where it is delivered within the state.

2. Tax base

Sales tax differences across states are largely due to variations in each state's tax base. These variations include the exemptions states offer, the services they choose to tax, and their legislative response to changing patterns in consumption.

States tend to provide similar exemptions. Historically, state policy makers have been reluctant to tax certain household necessities. As a result, items like groceries and prescription medicine are exempt in many states. Nevertheless, states like Hawaii, South Dakota, and others have adopted a truly broad tax base that includes such items. Exemptions for production machinery are also common. Table 5 and Table 6 below list the significant tax exemptions New York provides and shows the number of other states (excluding New York) that provide a similar exemption.

Table 5. Other States' Consumer Exemptions	
Exemption	# States Exempting
Grocery Food Items	32
Drugs, Medicine and Medical Supplies	20
Clothing	5
Residential Energy	30
Cable Television Services	24

Table 6. Other States' Business and Other Exemptions	
Exemption	# States Exempting
State and Local Governments	38
Charitable Organizations	41
Machinery or Equipment Used in Production	32
Fuel, Gas, Electricity, Refrigeration and Steam Used in Research & Development and Production	32
Farm Production and Commercial Horse Boarding	36
Telecommunications and Internet Equipment	32
Research and Development Property	28

States' tax bases are also differentiated by the services they choose to tax. Overall, New York's taxation of services is comparable to that of other states. Of the 45 states that impose the sales tax, 30 tax services in some manner. The most common means of imposing tax on services is to tax specifically enumerated services. Only a few states (Arkansas, Hawaii, New Mexico, and South Dakota) have a broad sales tax on services.

An increasing number of goods traditionally sold and taxed as tangible personal property are being replaced by tax exempt digital products. Examples include:

- iTunes and music streaming services replacing CDs;
- eBooks replacing hardcopy and paperback books; and
- video-on-demand services through cable providers or online replacing DVDs.

The manner in which states have responded to this trend towards a digital economy has generated additional distinctions among states. In recent years 23 states have amended their sales tax to incorporate digital products. While the scope and structure of these amendments differ among states, they share a common purpose – to adapt the sales tax to better reflect what consumers are buying. With the exception of prewritten computer software, New York does not subject digital products to sales tax.

3. Tax rates

New York's 4 percent State rate compares favorably to other states – it ranks as the second lowest state rate in the country. New York does not fare so well, however, when local sales taxes are factored in. The average local rate in New York is high compared to the local rates in other states. For the 36 states that authorize local sales taxes, the average local rate is just 1.70 percent compared with an average local rate of 4.48 percent in New York. As a result, New York's combined sales tax rate of 8.48 percent is the seventh highest in the nation. It is higher than both the national average (6.0 percent) and neighboring states.

Table 7. Combined State and Local Sales Tax Rates in New York and Other Northeastern States

	Rate	Rank		Rate	Rank
New York	8.48%	7			
Connecticut	6.35%	31	New Jersey	6.97%	23
Maine	5.00%	43	Pennsylvania	6.34%	32
Massachusetts	6.25%	33	Rhode Island	7.00%	20
New Hampshire	N/A		Vermont	6.14%	45

4. Tax administration

The administrative burdens imposed by New York's tax are considerable, and in some areas New York vendors face complex sales tax procedures that are uncommon in other states. These include:

- local option sales taxes;
- additional taxes such as the school district utility taxes; and
- unique provisions like the local segmented tax.

5. Contribution to State Tax Revenue

The sales tax is an important source of revenue for almost all states. However, the degree of a state's reliance on the sales tax as a revenue source varies considerably by state. According to the Census Bureau's *State Tax Collections Report*, the sales tax accounts for nearly 17 percent of all New York State's tax receipts and is the second largest source of New York State tax revenue. Nationally, sales taxes account for a far greater share of state revenues– a full one-third of all state revenue.

Table 8 summarizes sales tax revenue as a share of total state revenue for those states that, like New York, employ a mix of personal income tax, business taxes, and a sales tax. Florida and Texas, for example, do not impose an income tax but collect upwards of 60 percent of their revenue from the sales tax. Table 8 shows that when compared with other states that impose both the sales and income tax, New York receives a very low share of its total revenue from the sales tax. In fact, only Vermont relies less heavily on the sales tax as a revenue source.

Table 8: 2012 State Taxes Collections By Source

Ranking by Share of Total State Taxes Attributable to Sales Taxes

For States with both Sales and Individual Income Taxes - NorthEastern States Highlighted

State	Rank	Property	General Sales Tax	Excise & Gross Receipts Taxes	Personal Income Tax	Corporate Income Tax	License Taxes	Other
Tennessee	1	--	54.3	20.4	1.5	10.2	10.7	2.8
Hawaii	2	--	48.9	16.0	27.9	1.5	4.7	1.0
Arizona	3	5.8	47.9	14.3	23.8	5.0	2.9	0.3
Mississippi	4	0.3	44.2	19.0	21.6	5.7	7.4	1.7
Indiana	5	0.0	42.2	16.2	30.3	6.1	4.0	1.1
Michigan	6	7.5	39.9	14.8	28.5	2.5	5.9	0.8
New Mexico	7	1.2	39.1	13.0	22.6	5.5	3.5	15.1
Kansas	8	1.0	38.1	11.6	39.0	4.3	4.3	1.8
South Carolina	9	0.1	36.4	15.8	38.5	3.1	5.6	0.4
Idaho	10	--	36.3	13.0	36.0	5.6	8.9	0.2
Arkansas	11	12.2	33.9	14.2	29.0	4.9	4.3	1.6
Nebraska	12	0.0	33.4	14.4	42.2	5.4	4.2	0.4
Georgia	13	0.4	32.0	11.8	49.1	3.6	3.1	0.1
Utah	14	--	32.0	14.9	42.5	4.5	4.4	1.8
Ohio	15	0.0	31.9	18.7	34.8	0.5	13.8	0.3
Louisiana	16	0.6	31.3	23.0	27.5	3.2	4.5	9.9
Iowa	17	--	30.9	14.2	38.7	5.4	9.6	1.2
Rhode Island	18	0.1	29.9	22.6	37.9	4.4	3.8	1.3
New Jersey	19	0.0	29.5	14.2	40.5	7.0	5.2	3.5
Kentucky	20	5.1	29.1	18.9	33.5	5.5	4.1	3.7
Missouri	21	0.3	28.7	15.4	47.5	2.8	5.2	0.1
Maine	22	1.0	28.2	18.1	38.2	6.1	6.7	1.7
Pennsylvania	23	0.1	27.8	24.2	30.7	5.6	8.0	3.6
Oklahoma	24	--	27.4	14.8	31.4	5.1	11.6	9.8
Wisconsin	25	1.1	26.3	17.1	42.5	6.0	6.7	0.4
California	26	1.9	25.4	9.0	49.0	7.1	7.7	0.0
Alabama	27	3.6	25.1	26.0	33.3	4.6	5.7	1.7
North Carolina	28	--	24.5	17.5	45.7	5.4	6.5	0.4
Connecticut	29	--	24.4	18.9	47.8	4.1	2.9	2.0
Minnesota	30	3.9	24.0	20.4	38.9	5.2	5.8	1.8
Maryland	31	4.4	23.9	18.1	41.7	5.2	4.4	2.2
West Virginia	32	0.1	23.8	25.2	32.8	3.6	2.6	11.8
Colorado	33	--	22.5	17.4	47.6	4.8	6.0	1.7
Massachusetts	34	0.0	22.3	9.8	52.3	8.8	3.9	2.8
Illinois	35	0.2	22.0	17.2	43.1	9.6	7.1	0.8
North Dakota	36	0.0	20.0	8.4	7.7	3.8	3.3	56.7
Virginia	37	0.2	19.2	13.0	56.3	4.6	4.3	2.3
New York	38	--	*16.6*	*15.3*	*54.2*	*6.4*	*2.7*	*4.8*
Vermont	39	34.4	12.4	22.7	21.7	3.5	3.7	1.6
U.S. Total			30..4	16.7	36.1	5.0	5.6	4.0

-- tax not levied at state level

(X) Does not impose tax.

Source: "State Tax Collections" (2012), U.S. Department of Commerce, Bureau of the Census.

6. Comparative Analysis

New York has a narrow sales tax base when compared to most other states. John L. Mikesell, a noted public finance economist, has separated state sales taxes into "broad" or "narrow" categories bases on two objective measures: C-efficiency and the breadth index. The C-efficiency measures the divergence between the effective sales tax rate and the statutory rate. The breadth index is the ratio of the sales tax base to personal income. New York has a narrow sales tax base under both measures[21].

Table 9. Sample of States with Broad and Narrow Sales Tax Bases*

Broad Based States	Narrow Based States
Arkansas	Connecticut
Hawaii	Illinois
Mississippi	Maryland
New Mexico	Massachusetts
Utah	New Jersey
Wyoming	New York
South Dakota	Pennsylvania

* As defined by John L. Mikesell, *The Disappearing Retail Sales Tax,* State Tax Notes, March 5, 2012.

Broad-based states tend to be in the western part of the United States while many of New York's neighboring states in the Northeast are characterized as narrow. Mikesell finds that the remaining states have an "average" tax base. These states include Maine, Vermont, Michigan, Ohio, Indiana, Florida and Georgia.

Other measures such as tax per capita and tax per $1,000 of state personal income are commonly used to compare state taxes. New York has a relatively low state-only rate in addition to local rates that are generally higher than those in other states. This discrepancy would skew an analysis of state sales tax burdens using these measures and is thus not appropriate here.

F. Sales Tax Collections and Liability

In SFY 2012-13, the State sales tax yielded $11.3 billion on about $275 billion in taxable sales and purchases (referred to together as taxable sales). Sales and use taxes collected at the local level yielded another $14.2 billion during the same period.

1. Taxable Sales by Type of Seller

The majority of taxable sales in New York are made by vendors in the retail trade and the accommodation and food service industries.[22] These two industries account for 60 percent of the sales subject to New York's sales tax (see Figure 2).

- In SFY 2010-11 vendors in retail trade accounted for roughly 47 percent of total taxable sales. This represented nearly $120 billion in retail sales subject to the State

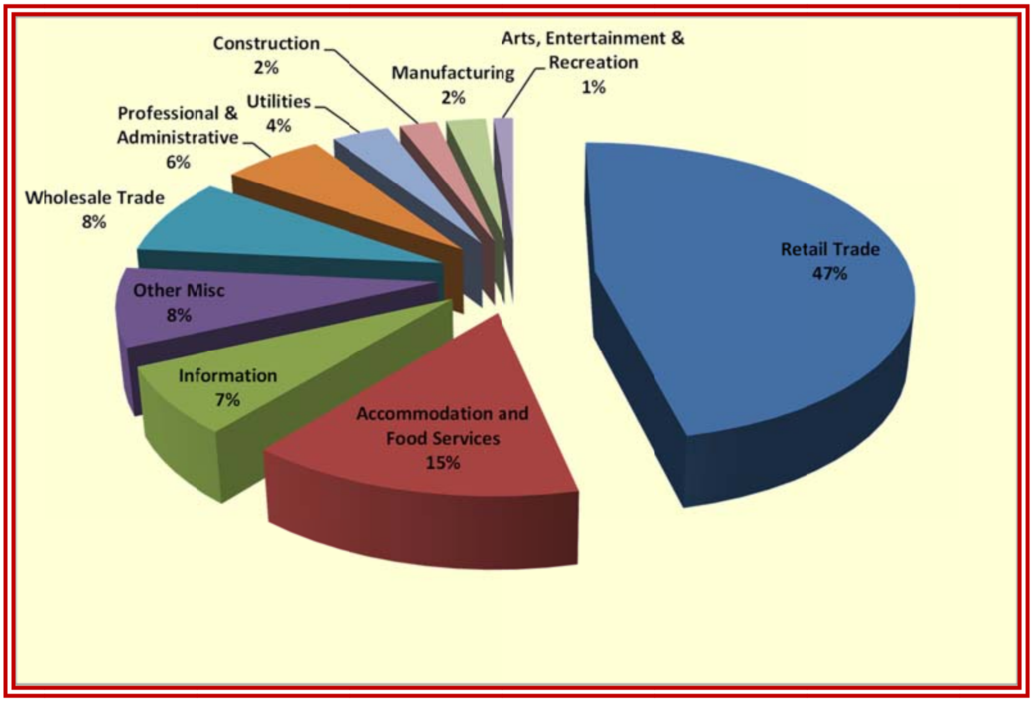
[21] Mikesell, John. "The Disappearing Retail Sales Tax Base", State Tax Notes, March 2012.

[22] The "taxable sales" metric allows for the sales tax base to be measured on a liability basis rather than a collections basis. It provides a more accurate measure of the State's tax base relative to collections data and allows for a consistent comparison of taxable sales trends across industry sectors and regions.

sales tax. Retail trade includes, for example, automobile dealers and furniture, electronic and general merchandise stores; and

- During the same period, vendors in the accommodation and food services industries reported nearly 15 percent of taxable sales. These industries include hotels and restaurants.

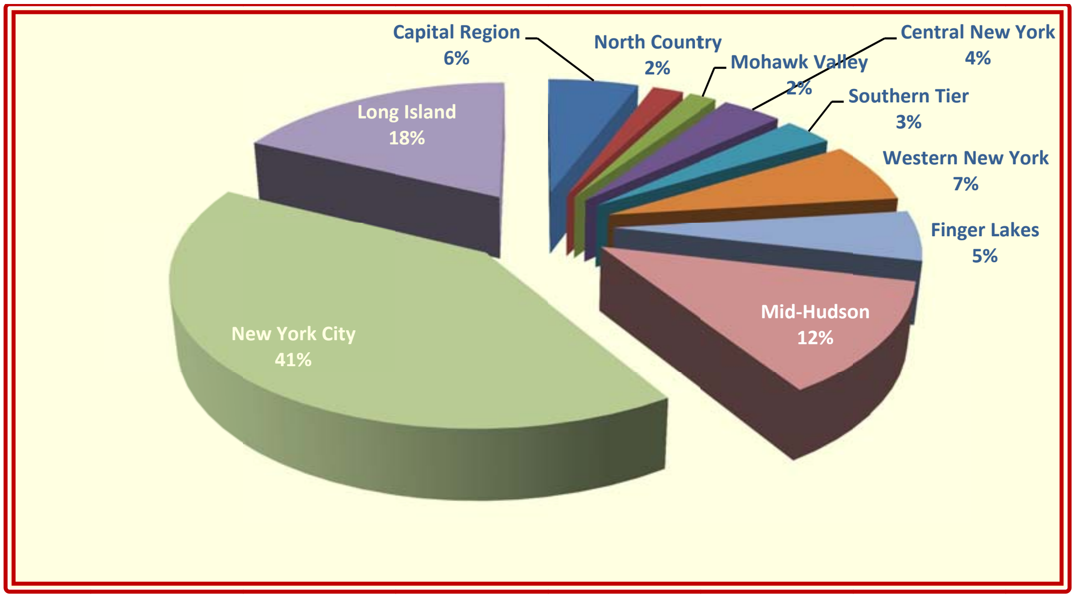
Figure 2. Taxable Sales by Industry: (March 2010 through February 2011)



2. Taxable sales by region

By region, the three downstate regions (New York City, Long Island, Mid-Hudson) account for approximately 71 percent of the taxable sales in the State. The remaining seven upstate regions comprise the balance (29 percent) of the taxable base (Figure 3).

Figure 3. Taxable Sales by Region



3. Taxable sales by purchaser type

While generally characterized as a tax on individual consumers and households, the sales tax applies to many sales made to businesses and sales to individuals from other states (e.g., tourists, commuters, and travelers). Research conducted by the Department of Taxation and Finance finds that an estimated:

- 58 percent of taxable sales are made to New York households;
- 37 percent of taxable sales are made to New York businesses; and
- 5 percent of taxable sales are made to tourists and other nonresidents.

4. Revenue Disposition

Most collections from the State 4 percent sales tax get deposited in the State's General Fund. However, 25 percent of net tax collections are diverted to the Local Government Assistance Tax Fund to support bonds issued by the Local Government Assistance Corporation (LGAC). Most of the revenue diverted to LGAC (86 percent in SFY 2011-12) is subsequently transferred to the General Fund after the debt service requirements are satisfied.[23]

Legislation passed with the 2013-14 State Budget will divert collections attributable to tax from a one percent sales tax rate to a "sales tax revenue bond tax fund" to support future revenue bond issuances. Collections in excess of debt service requirements will be transferred to the General Fund.

[23] In addition, receipts from the MCTD sales tax are deposited in the Mass Transportation Operating Assistance Fund; receipts from the hotel unit fee support bonds issued by the convention center development corporation; and receipts from the additional auto rental taxes are deposited in the Dedicated Highway and Bridge Trust Fund and the MTA Aid Trust Account.

Most counties in the state share some portion of local sales tax revenue with cities, towns, villages, or school districts. These sales tax revenue sharing agreements are based on population, real property valuation, and/or other factors.[24]

II. Evaluation

A. Requirements of "Good Tax Policy"

Under generally accepted public policy principles, states would impose retail sales taxes on a broad tax base at a low uniform rate, and exempt business purchases to eliminate tax pyramiding. Only final sales to consumers would be subject to the tax. This "ideal tax" would maximize the extent to which the tax satisfied the criteria commonly used to evaluate taxes.

Part I of this report described the New York sales tax and how it developed over time. As described, the tax was not designed with these criteria in mind and no serious effort has been made to recast the State and local sales tax into a structure more closely aligned with the principles highlighted above. Rather, the number of exemptions has grown significantly and the tax base has failed to adapt to current consumption patterns or new technologies.

The same is not true with respect to tax administration. Sales tax Web file, e-licensing and the use of data analytics to maximize audit and compliance resources are highly evolved and far removed from past administrative practices.[25]

In order to consider specific reform options, it is first necessary to document and quantify, where applicable, problem areas. To inform this discussion, this report uses the generally accepted tax evaluation principles as our benchmarks – revenue adequacy, equity, simplicity, and neutrality.

Tax reform options will need to balance these principles with the overall policy priorities within the sales tax itself and across New York's broader tax system.

B. Sales Tax Revenue Adequacy

Revenue adequacy is arguably the most important policy criterion in analyzing major state taxes such as the sales tax. The sales tax is an important component of New York's taxing system and as such it is vital to understand how it has performed in this capacity.

A well-performing tax should deliver a predictable stream of revenue over a longer term and a fairly stable stream of revenue over the business cycle. This section examines the productivity of the State tax base over both the short and long terms.[26]

[24] For more information on local use of sales tax revenue see the Office of the State Comptroller, Division of Local Government and School Accountability report *Local Government Sales Tax*.

[25] See, for example, the discussion of tax administration shortcomings in *Report to the Governor: The New York State Sales and Use Tax*, by the Governor's Temporary Commission to Review the Sales and Use Tax Laws. James H. Tully, Chairman, December 15, 1979.

[26] This report examines the State sales tax only. Locally imposed sales taxes have many additional factors (e.g., differing tax rates, tax bases) and are beyond the scope of this review.

1. Revenue and Tax Base Trends

The sales tax generated just over $11 billion in revenue during SFY 2012-13. This is roughly double the annual revenue yield of twenty years ago. However, the graph of the revenue produced by the tax (Figure 4) masks the true performance of the sales tax over time as a contributor to State revenues.

Figure 4: NYS Sales & Compensating Use Tax By State Fiscal Year Ending ($billions)

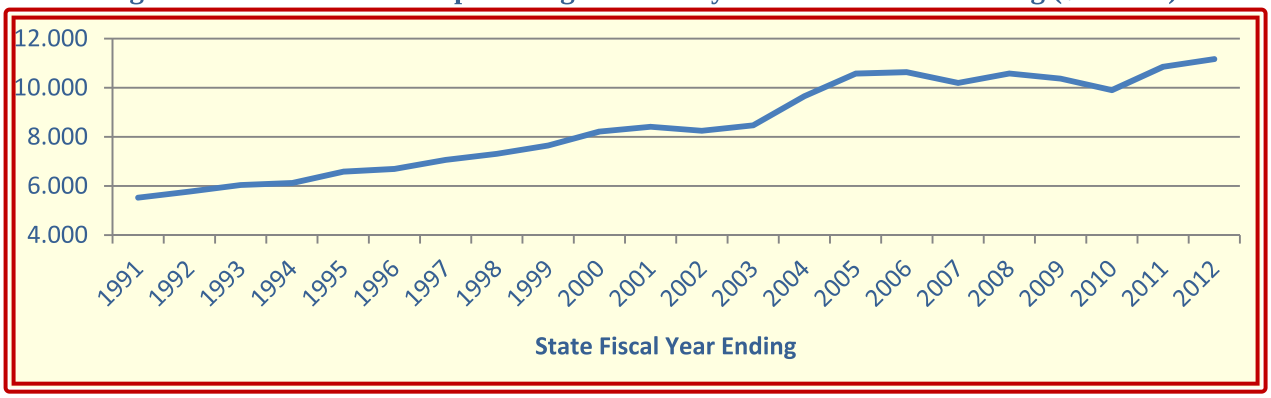
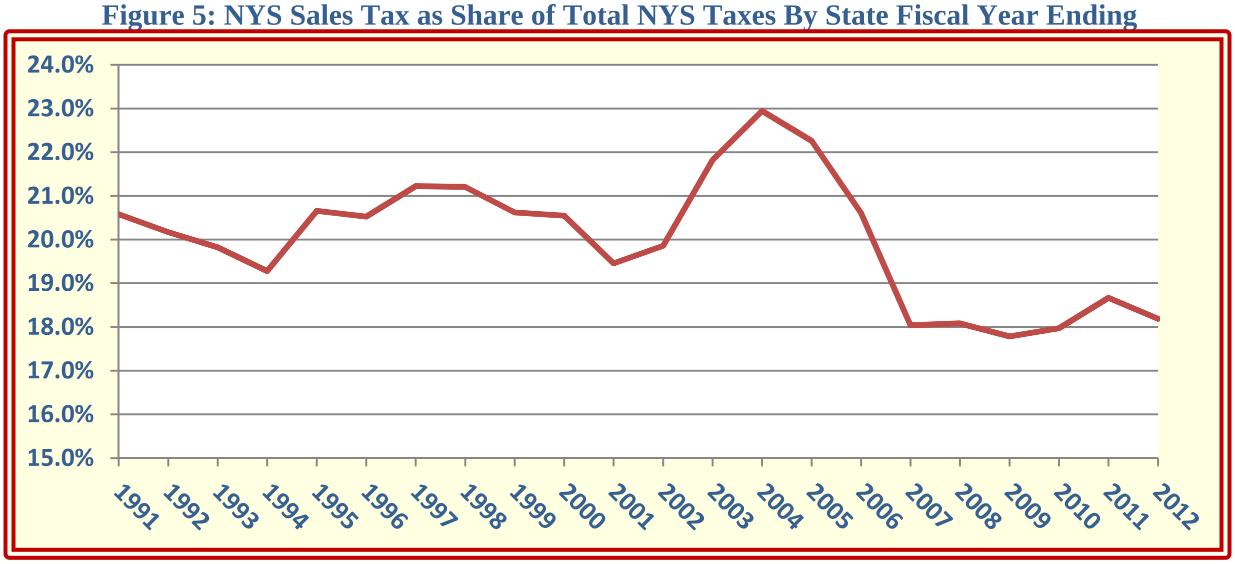


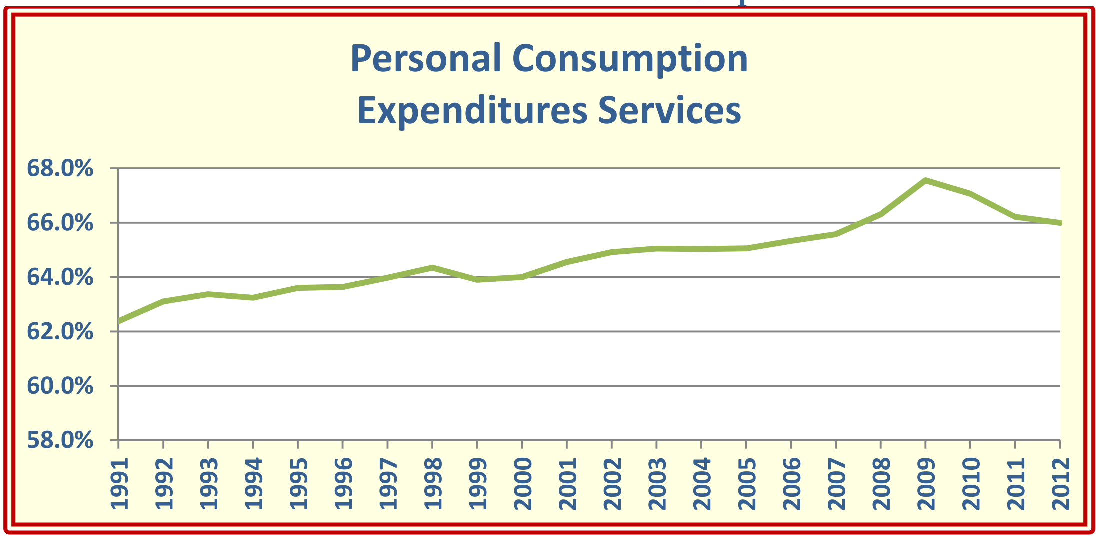
Figure 5 reveals that the sales tax share of State tax collections was relatively stable at 20 to 21 percent of total State tax collections from the early 1990's through SFY 2003. Collections spiked between June 2003 and May 2005 as a temporary tax rate increase from 4 to 4.25 percent and a temporary suspension in the clothing exemption were enacted in the aftermath of the 2001 recession. These actions increased the sales tax share of State tax collections to roughly 23 percent. The spike was quickly reversed, however, with the expiration of the temporary legislation and the resulting decline in collections. The decline accelerated with the enactment of the sales tax cap on motor fuel (June 2006) and the State sales tax share fell to 18 percent in SFY 2006-07.

Figure 5: NYS Sales Tax as Share of Total NYS Taxes By State Fiscal Year Ending



National economic trends have also played a role in the decline of the sales tax as a revenue source. For example, almost every state excludes most services from their sales tax, relying on a tax base consisting of the purchase of goods (tangible personal property). As the United States shifted to a predominately service based economy this has the effect of narrowing state sales tax bases. That is, consumers are spending a smaller percent of their dollars on taxable items. Figure 6 provides a trend line showing this change nationally over the last twenty years. Services now represent about two-thirds of United States personal consumption.[27]

Figure 6: US Personal Consumption on Services As a Share of Total Personal Consumption



Further, the growing national market shares of digital products and remote sales (e.g., sales made by Internet retailers) have also resulted in the diminution of taxable sales as a percent of all consumption.[28]

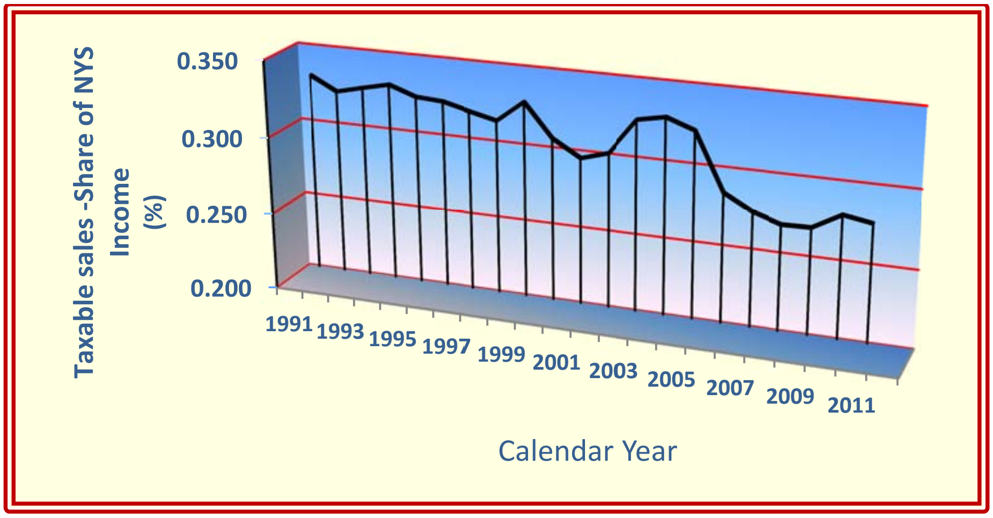
While Figure 4 above showed State sales tax collections largely growing in nominal terms over the last twenty years, Figure 7 below tells a much different story. Figure 7 is constructed to measure the State's taxable sales base as a share of the State's economy over the last twenty years. State personal income is used as the proxy for the economy.[29]

[27] U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey.

[28] States are constrained by several Supreme Court decisions in the extent to which they can require out-of-state businesses, such as Internet retailers, to collect their sales taxes.

[29] This is a much better measurement tool than tax collections because it is not affected by tax rate changes, changes in the timing of tax payments or audits, and it accounts for relative income and price inflation. It also allows for analysis of the long-term growth of the sales tax base as a share of the economy – an important component of a well performing tax.

Figure 7: NYS Taxable Sales as Share of NY Personal Income



The downward trend in New York State's sales tax base relative to personal income is evident in Figure 7. For example in 2004, taxable sales represented 32.8 percent of the State's economic base. With 2004 State personal income at $734 billion, this translates to a taxable sales base of $241 billion or $9.6 billion in applicable State sales tax at a 4 percent tax rate. Comparatively, in 2011, the sales tax base dropped to a 28 percent share of the State's economic base. Using the State's 2011 personal income base of $977 billion, the decline in the tax base from 32.8 to 28.0 percent as a share of personal income reduced the taxable sales base roughly $47 billion, or $1.88 billion in tax.

As noted, New York's sales tax base is among the narrowest in the country. Three major exemptions explain much of the comparative narrowness of New York's tax base. One of these (residential energy) has been exempt since the 1980s. The more recent impacts on the base are the exemptions for clothing and footwear that took effect in 2000 and the 2006 sales tax cap on motor fuels.[30] Figure 8 compares the actual base to a base in which these exemptions had not been enacted. For example, in 2011, the inclusion of clothing and motor fuel receipts above the $2 cap in the tax base would have increased taxable sales by $18.2 billion (or approximately 6.8 percent of the base); this translates to approximately $730 million in annual tax revenue.

[30] The State's sales tax base on sales of motor fuel was capped at a $2 taxable receipt effective June 2006. The sales tax is now a fixed 8 cents per gallon irrespective of actual retail price.

Figure 8: NYS Taxable Sales as Share of NY Personal Income Adjusting for the Clothing and Motor Fuel Exemptions

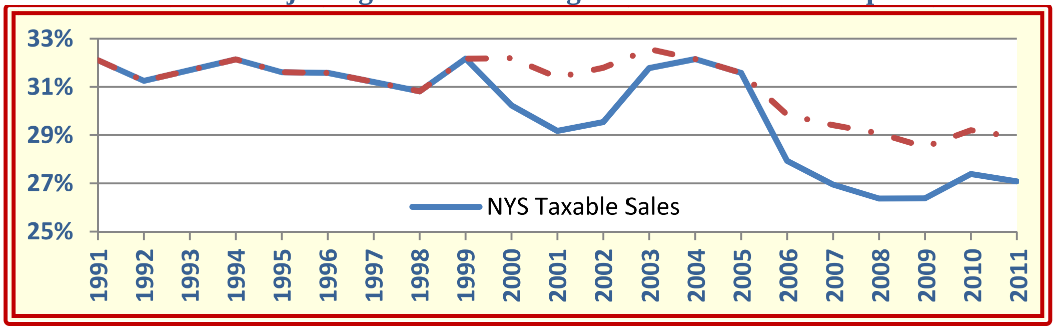
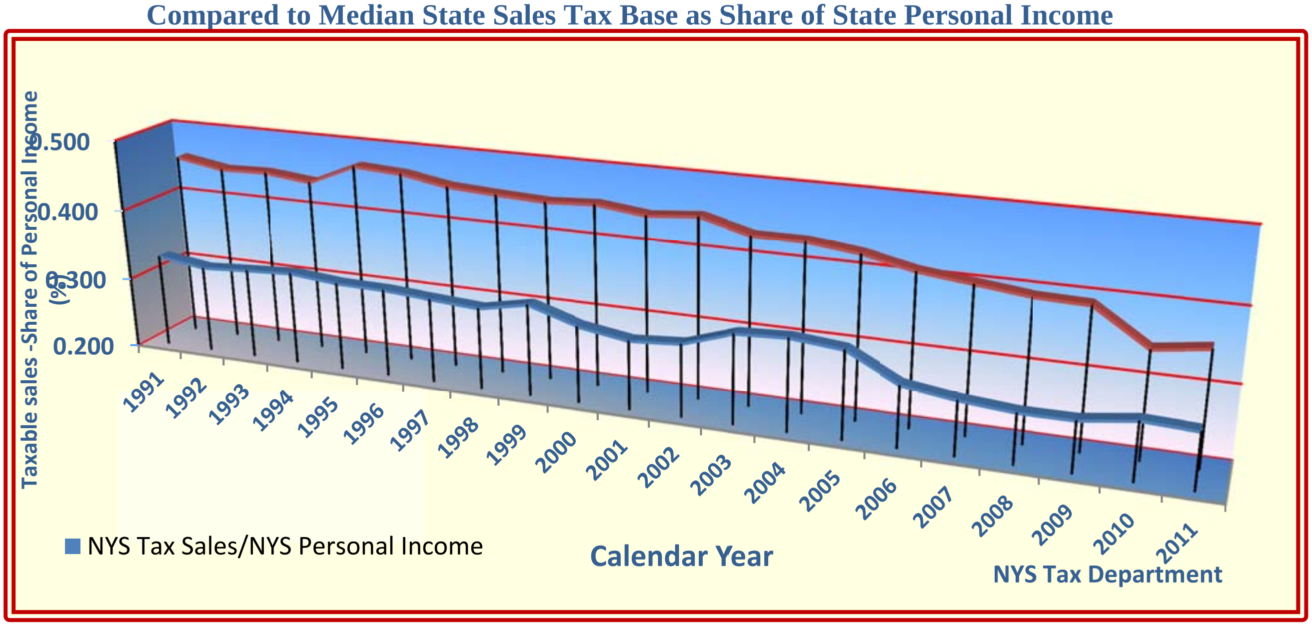


Figure 9 illustrates the relative narrowness of New York's sales tax base by comparing it to the median state's sales tax base as a share of personal income.[31] The graph reveals that New York's sales tax base as a share of the State's economic base has been significantly below the comparable median state during the last twenty years. To highlight the impact of the narrowness of New York's tax base coverage, if, in 2011, New York had a tax base as broad as the median state it would have had $77 billion in additional taxable sales or, equivalently, $3 billion more in State sales tax receipts.

Figure 9: NYS Taxable Sales as Share of NY Personal Income Compared to Median State Sales Tax Base as Share of State Personal Income



[31] The median state sales tax base annual coverage percentages from 1991 through 2011 are from Mikesell (2012)

2. Revenue Stability

Revenue stability is a related criterion for assessing how well a tax is performing as a revenue source. It measures the impact of the business cycle on individual taxes and the tax system as a whole.

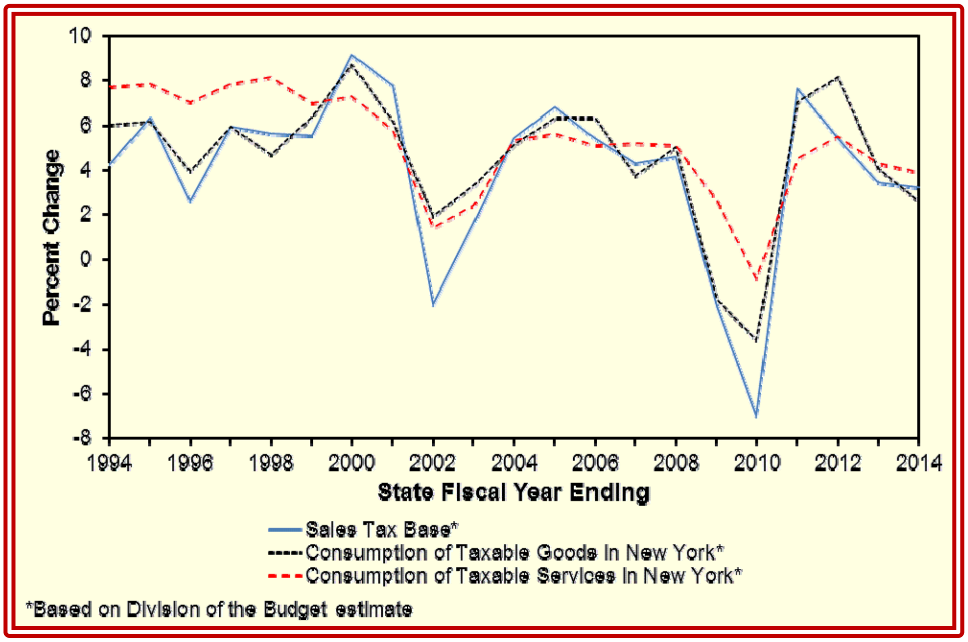
Ideally, tax revenue streams should not vary dramatically during periods of economic contraction and expansion. One factor that impacts the volatility of a state's sales tax is the narrowness of its tax base. Consumers may reduce consumption of some goods and services during economic contractions and a narrow tax base that exempts necessities tends to exacerbate the impact of this reduction.[32] As consumers' confidence declines, their spending may become more focused on purchases of goods that are necessities such as food, clothing, residential energy, motor fuel and health related items. If these necessities are excluded from the sales tax base, these exemptions increase the volatility of the sales tax in response to an economic downturn.

The composition of a tax base between durable and non-durable goods also affects its volatility. During economic downturns, consumers may delay purchases of durable goods such as motor vehicles, furniture, appliances and home entertainment systems. Consequently, sales taxes that rely heavily on sales of durables will be more volatile than those with broader bases.

Figure 10 provides a graphic view of changes in New York's State sales tax base as compared the changes in consumption of goods and services in New York over the last twenty years, with estimates for fiscal years ending in 2013 and 2014.[33] It is evident that the sales tax base largely moves in tandem with consumption trends.

[32] The extent to which this occurs depends on individual household budget constraints. As you move up the economic strata, households have more discretionary income and savings to maintain consumption patterns if they choose to do so.
[33] Source: NYS 2013-14 Executive Budget, *Economic & Revenue Outlook,* p.260.

Figure 10 Historical Sales Tax Base Growth



3. Findings

Sales tax receipts have steadily increased over the past few decades, despite a narrow tax base. However, this increase has lagged other indicators of economic growth, such as State personal income. If New York had a tax base as broad as the comparable median state it would have about $3 billion more in annual State sales tax receipts at the current 4 percent tax rate. Alternatively, current levels of revenue could be raised at a reduced 3 percent rate.

C. Equity

The point is universally made in analyses of state tax systems that sales taxes, when measured as a share of income, are disproportionally paid by lower-income households relative to more affluent households. Sales taxes are, in this respect, not fair.

In response, New York exempts many transactions involving products generally perceived to be necessities, such as food, clothing, and health related products. Nevertheless, the tax remains regressive while much of the financial benefit from these exemptions goes to affluent households. There is no practical solution to change this outcome.

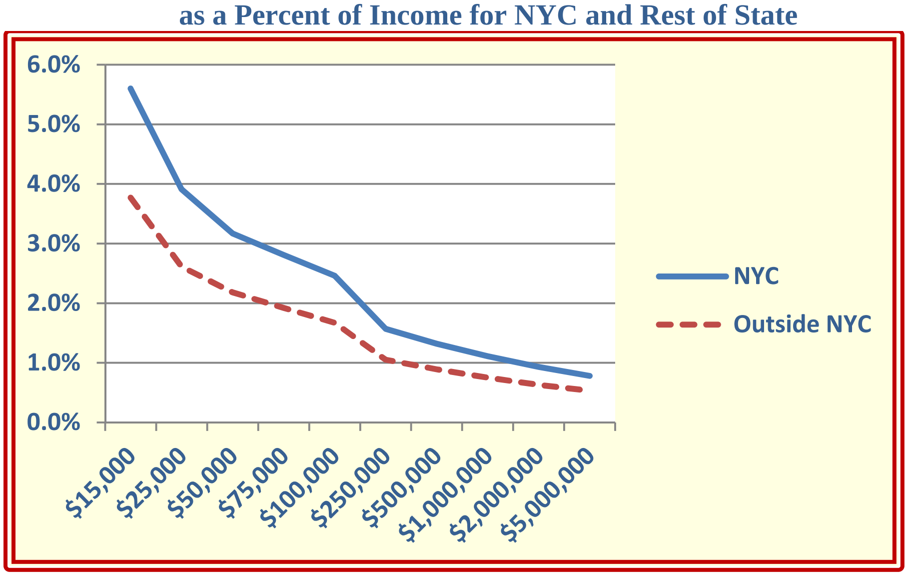
1. Vertical equity

To analyze fairness, public finance economists developed a definition of equity based on an individual's ability to pay. Vertical equity refers to the idea that people with a greater ability to pay taxes should pay more. A tax structure that has strong vertical equity is referred to as being progressive – when the ratio of tax paid to income rises as incomes rise. A vertically "unfair" tax is regressive such that the ratio of tax paid to income falls as incomes rise.

The Institute on Taxation and Economic Policy (ITEP) developed a series of estimates measuring the "sales tax burden" by state. Based on its analysis, ITEP found that the sales tax is one of the most regressive components of state and local tax systems, with poor families paying eight times more of their income in these taxes than wealthy families, and middle income families paying five times more (ITEP 2013).[34]

Using a model similar to ITEP's, based on a typical two-person household with two dependents, and using 2011 data,[35] we estimated the sales tax burden specifically for households in NYC and the rest of the state (i.e., outside NYC).[36] Our results reflect the well-known regressive feature of the sales tax, shown in Figure 11 for a typical New York household.

Figure 11: Typical Household: State and Local Sales Tax Burden as a Percent of Income for NYC and Rest of State



[34] "Who Pays? A Distributional Analysis of the Tax Systems in all 50 States." Institute on Taxation & Economic Policy. January 2013.

[35] Vertical equity is measured based on consumer expenditure and income data from the Consumer Expenditure Survey (CES). The CES is published annually by the U.S. Bureau of Labor Statistics and contains information on the range of consumers' expenditures and incomes, as well as the characteristics of those consumers.

[36] CES data generally are not available over the $250,000 income level. For purposes of the representative taxpayer analysis, we extrapolated these results using reasonable assumptions to obtain estimates of the upper income groups.

Higher income taxpayers pay more in taxes in a dollar amount, but this is a significantly smaller percentage of income compared to lower-income households. For example, a representative household in New York City with a $250,000 income pays, on average, nearly $4,000 in annual sales tax. However, this is a much smaller share of their income when compared to, say, a household earning $50,000 (1.57 percent vs. 3.17 percent) that pays about $1,600 in tax.

As indicated by Figure 11, the sales tax burden relative to income is substantially higher at every income level for a New York City taxpayer relative to the rest of New York State. A non-NYC taxpayer pays about one-third less in sales tax for a given income compared to a City taxpayer. This disparity is due to the higher local sales tax rate in New York City, the City's broader local sales tax base, and a higher level of spending across all expenditure categories relative to other parts of the State.

2. Horizontal equity

The concept of horizontal equity plays a role in evaluating the fairness of a tax. This principle holds that purchasers with similar income and assets, should pay the same amount in taxes.

The more horizontally equitable the tax is in its application among similarly situated individuals, the more neutral or "fair" the tax system will be considered.

3. The Efficacy of Tax Exemptions for "Necessities"

It is clear that vertical equity is the policy rationale for the exemptions for grocery food, clothing, prescription and non-prescription drugs and medical supplies (hereinafter collectively referred to as "necessities").[37] These are items that all persons, regardless of income, purchase for everyday use. Collectively, these exemptions reduce State sales tax receipts by about $3.2 billion annually, so it is informative to examine who actually receives the tax savings.

Effect on vertical equity

We adjusted the vertical equity analysis presented above to model a sales tax base that fully taxed food for home consumption, clothing and footwear, drugs and medical supplies.[38] As Figures 12 and 13 below illustrate, removing these "necessary" items from the tax base produced significant tax savings across all income groups, yet only mildly alleviates the inherent vertical inequity of the tax.

[37] Economic development is another justification for the clothing exemption, as it may reduce the incentive to shop in the neighboring states that also exempt such items or on the Internet.

[38] For this analysis, we opted to use only the income levels for which there are CES data and set aside the upper income levels for which these data do not exist. Also, as a practical matter, purchases with food stamps would still be exempt from tax as states must offer this exemption in order to participate in the federal food stamp program.

Figure 12. Representation of Vertical Equity
Current Tax Base vs. Base with Necessities Taxed – NYC

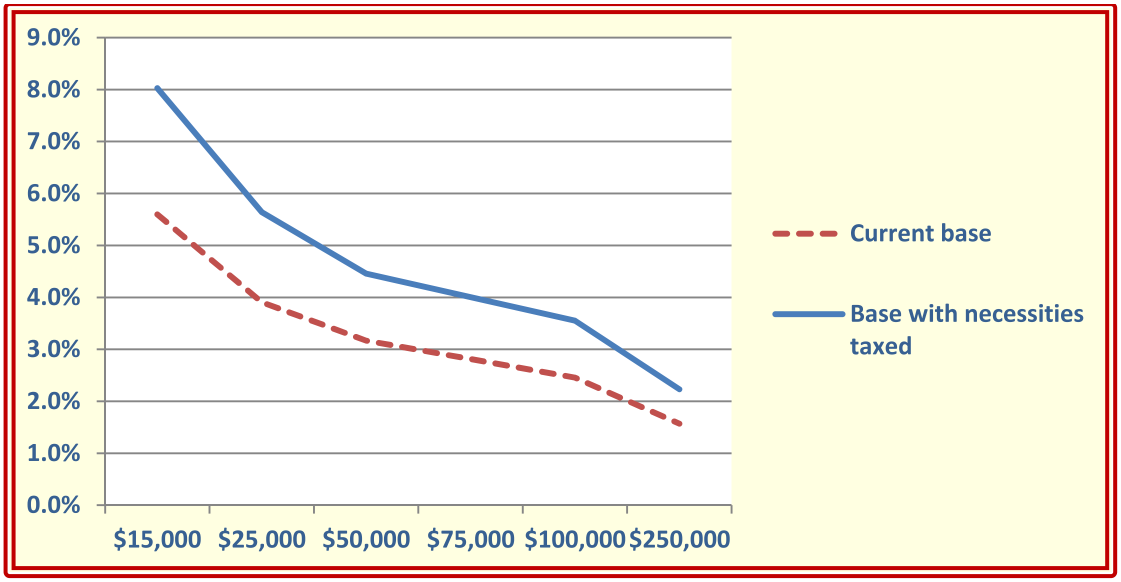
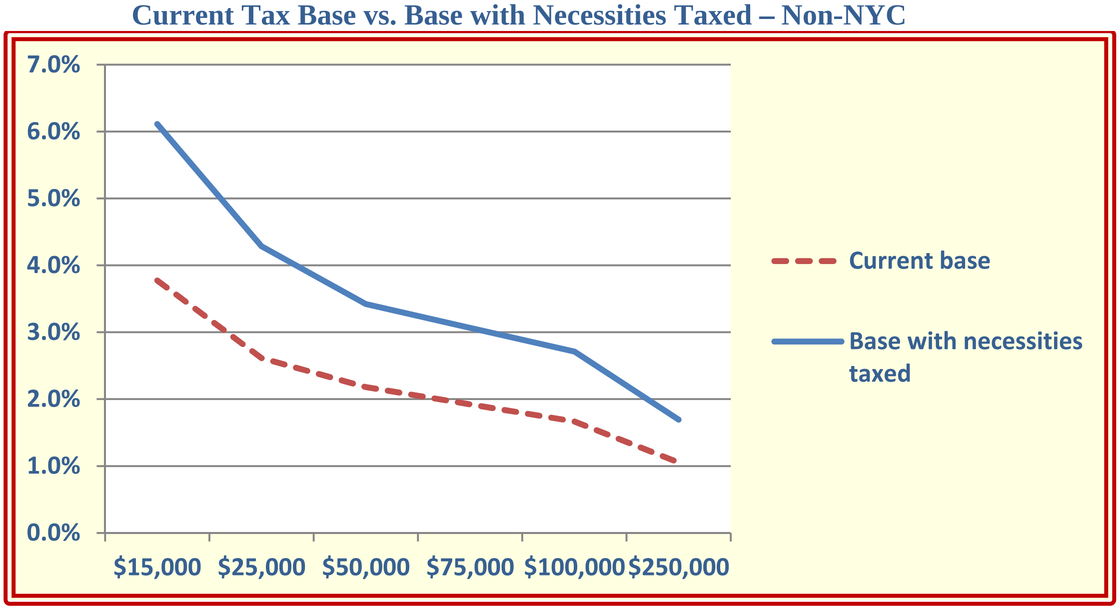
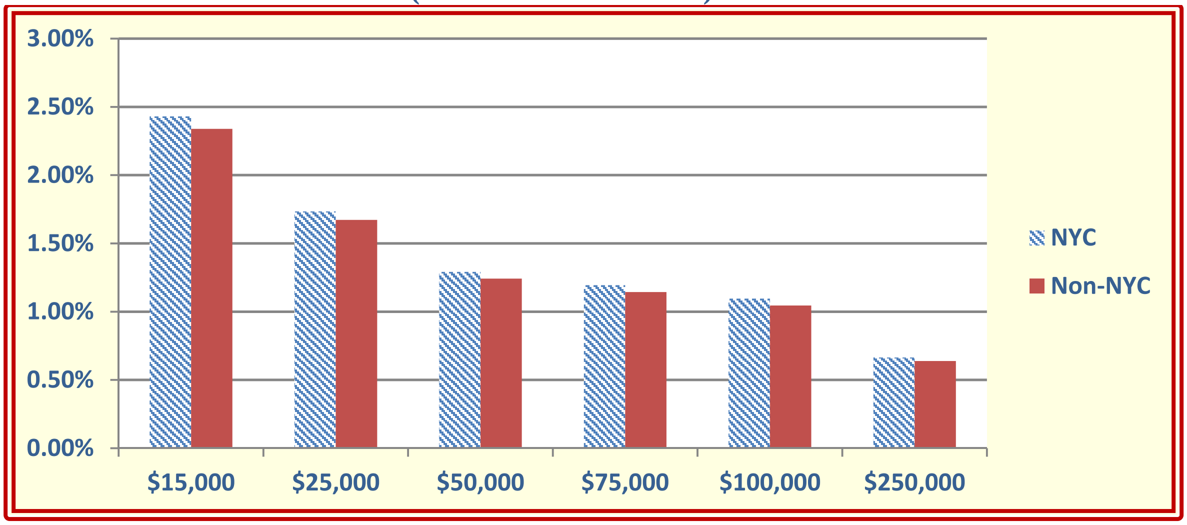


Figure 13. Representation of Vertical Equity
Current Tax Base vs. Base with Necessities Taxed – Non-NYC



These exemptions do provide a proportionately greater benefit to lower-income households when looking at tax savings as a percentage of income. The spread between the lines in the above Figures represents the percent of income saved for each income group due to these exemptions. The lines tend to converge as income rises, illustrating the smaller percentage savings for the higher income levels. This is an expected result. Lower income households pay more in tax as a share of income, so they must also save more as a share of income when an otherwise taxable product is exempted. Actual percentages are provided in Figure 14.

Figure 14. Tax Savings Due to Exemptions for Necessities (as a Percent of Income)

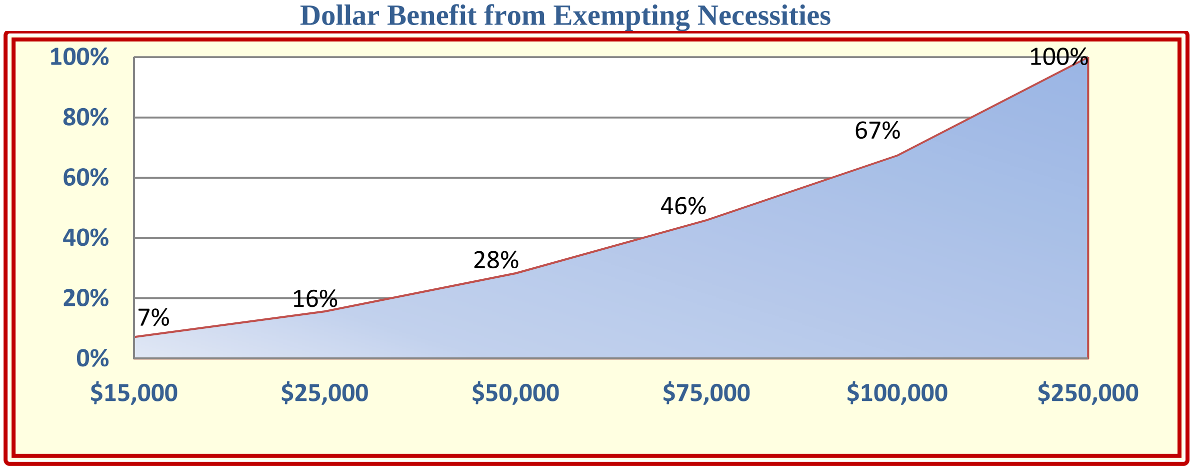


Distributional impacts

If we move away from using tax as a percentage of income as the means by which to analyze the exemptions for necessities, it becomes apparent that exempting necessities is an inefficient way to provide benefit to lower-income households.

Sales tax exemptions are inefficient because every household, regardless of income, receives the benefit of the exemption. Of the $3.2 billion the State spends annually on these tax exemptions, only $500 million (16 percent) accrues to households earning under $25,000 and $900 million (28 percent) to households earning under $50,000. The $1.8 billion balance of this tax benefit goes to households earning over $50,000 with the majority ($1 billion, or 33 percent) going to households with incomes over $100,000 per year.

Figure 19. Cumulative Percentage Distribution of the Dollar Benefit from Exempting Necessities



The structure of a retail sales tax does not allow for exemptions to be targeted to persons of a certain income. It would be highly impractical to try and limit a point-of-sale exemption to persons of a certain income. Thus, there is no practical mechanism to mitigate the fact that most of the dollar benefit from the exemptions for necessities does not go to disadvantaged households.

4. Findings

New York's sales tax, like that of all other states, takes a larger proportion of a low-income household's earnings than it does when compared to the share from an affluent household. Items basic to everyday life such as food, clothing, and health related products are not subject to tax. However, much of the dollar benefit from these exemptions accrues to upper income households that are not in need of this relief.

Options to make the tax more equitable are limited. As we have seen, the State forgoes billions in annual revenues to exempt necessities, yet the tax remains regressive.

The most common alternative to tax exemptions is targeted sales tax credits to provide tax relief. Five states currently tax food but provide an income tax credit for lower-income households to offset the burden of paying tax on this necessity.

ITEP has a policy brief suggesting that credits are a better alternative than sales tax exemptions in addressing vertical equity issues, even though they have some disadvantages.[39] They suggest policymakers consider using the Earned Income Tax Credit to offset some of the regressivity in the sales tax.

The Center on Budget and Policy Priorities notes some of the disadvantages of this approach.[40] Their primary concern is the failure of all eligible families to claim the credit to which they are entitled. Other concerns include the tendency for the credit offset to be less than the amount actually paid in tax and the lack of a cost of living factor built in to the amount of the credit.

D. Tax Simplicity

Tax simplicity represents a third core principle of good tax policy. Succinctly put, taxes should be easy to understand and comply with. A tax should avoid complex provisions and regulations, multiple filing and reporting requirements, and numerous exemptions. The Tax Law should be as simple as possible so that vendors understand the rules and can comply with them correctly and in a cost-effective manner.

A complex tax creates financial risk for vendors who "get it wrong," increases the costs of doing business in the State, diminishes voluntary compliance, and adds to government administrative costs.[41]

1. Tax exemptions introduce complexity

A general consensus exists among public finance economists and tax administrators that tax exemptions contribute to a significant amount of sales tax complexity.

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[39] *Options for Progressive Sales Tax Relief*, ITEP Policy Brief, July 2011.
[40] Nicholas Johnson and Iris J. Lav, *Should States Tax Food?*, Center on Budget and Policy Priorities, April 1998.
[41] Vendors bear the financial risk in cases where they "get it wrong" and fail to collect the correct tax from their customers. The vendor's responsible officers are personally liable for uncollected sales tax.

New York currently offers 150 different sales tax exemptions, significantly more than most other states. Each exemption complicates tax collection. Vendors are unable to determine the taxation of a retail sale based solely on the nature of the sale. Instead, sales tax collection can turn on what the product is, who is purchasing it, how it is being paid for, or its intended use. The finer the distinctions and details of an exemption, the more difficult and costly it becomes to comply.

In addition to the complexity introduced by product exemptions, additional complexity arises when "caps" and "thresholds" are used to fine tune an exemption. For example, the sales tax exemption for clothing and footwear only applies to items priced below $110. The $110 price threshold generates its own set of issues: Do manufacturer coupons count toward reducing the price? Can a two-piece outfit be priced as individual items? Are alterations included as part of the price?

2. Other aspects of the sales tax that introduce complexity

Tax exemptions are not the only feature of the sales tax that introduces complexity. Other features most commonly identified as adding to complexity include:

- the presence of local taxing jurisdictions;
- the use of more than one tax rate by a jurisdiction (State or local); and
- where local jurisdictions exist, a lack of uniformity in the State and local tax base

A simple sales tax would:

- have few taxing jurisdictions;
- apply a single tax rate to taxable sales; and
- be uniform with respect to the State and local tax base.

3. Findings

It is clear that New York's sales tax is not simple given its numerous exemptions and other features such as non-uniform local taxes. Nevertheless, the desire for tax simplicity must be balanced against competing policy goals (e.g. a desire for tax fairness). Furthermore, tax exemptions and other rules can serve to meet specific purposes to provide certainty in complex tax situations.

E. Neutrality

The final tax evaluation criterion we consider is economic neutrality. A neutral tax is one that does not distort the economic decision making process of consumers or businesses. In other words, an efficient or neutral sales tax should "stay out of the way of economic decisions."[42]

1. Analysis

In a neutral sales tax, the base and rate are calibrated so that the tax structure does not distort consumer or business behavior. Tax neutrality is often used as a justification for a "broad base and low rate" sale tax structure.

Certain features of New York's sales tax can influence purchasing decisions:

- similar products and services are taxed differently;
- business inputs are taxed differently in different industries; and

[42] *The ITEP Guide to Fair State and Local Taxes,* ITEP, 2011, p. 7

- economic development incentives encourage business growth in areas where businesses might otherwise not locate.

Economic development incentives

Neutrality may be undesirable if policy makers intend to promote new business growth in an area where a business might otherwise not locate. In such situations, economic distortions are intentionally created to incentivize certain activities.

2. Findings

Overall, New York's sales tax is neutral. However in some instances economic development efforts violate the neutrality principle by encouraging growth in key industries or certain areas of the State.

As indicated above, the principle reason for a tax system is to raise revenue to pay for publicly provided goods and services. Public finance literature looks primarily at two components of a tax or tax system to judge its performance, revenue sufficiency (or long-term adequacy) and revenue stability (or short-term adequacy.)

Revenue Sufficiency (Long-Run Income Elasticity)

The concept of revenue sufficiency entails assessing the long-term revenue adequacy of an existing tax (or tax system's) revenue or tax base by utilizing a statistical measure that allows policy makers to understand how a state's tax base responds to changes in the state's economy. This is a particularly important task at the state level where policy makers must both balance their budgets each year and understand the dynamics of their budget planning over a time horizon of five or even ten years.

The revenue trends section above discussed several factors affecting the State's sales tax base growth over the last five or ten years. For example, it discussed the relative growth of services versus goods as a share of personal consumption in the US economy. This consumption shift impacts the trend in the growth rate of the tax base. If services are growing faster in the economy than goods, and sales taxes are imposed primarily on goods, the taxable consumption base will grow slower relative to the State's personal income.

The trend in the growth rate of the tax base is also affected by the enactment of tax exemptions. For example, sales tax exemptions created for clothing and motor fuel will affect the sales tax's long term growth rate. This is particularly true of motor fuel where higher pump prices require bigger chunks of household budgets and likely crowd out other taxable spending. Suffice to say that many economic factors and policy choices affect the trend growth rate of the State's sales tax base.

To measure the trend in the long term growth rate of a tax with respect to the economy, public finance economists have settled on a common technique that produces a single statistic (metric) that policy makers can use to evaluate the revenue sufficiency of a tax or tax system. This metric is the long run elasticity of the state's tax base with respect to its personal income (a proxy for the economy). For those unfamiliar with the concept of income elasticity it is defined in this case as the percentage change in the tax base divided by the percentage change in personal income for adjacent time periods (e.g., $\text{year}_{t} - \text{year}_{t-1}$) Economists have developed a simple econometric equation to calculate this elasticity statistic. The equation is expressed in logarithmic form as[43]:

Equation 1:

$$Log(Sales\ Tax\ Base)_t = \boldsymbol{a} + \boldsymbol{b}\ Log(Personal\ Income)_t + e_t$$

[43] The logarithm referenced here is the natural logarithm. The use of a logarithmic formulation here is for ease of interpretation because the coefficient on the income variable is the elasticity value. For discussion of this model formulation see, for example, Sobel and Holcombe (1996) & Bruce, Fox & Tuttle (2006). The data series for each of the log variables are non-stationary in levels but they are each stationary in first differences; they are also cointegrated in log level terms allowing the use of this model.

Where:

- the dependent variable is the log of the sales tax base at time t
- the independent variable is the log of the State's personal income at time t
- **a** is an intercept term
- **b** is the coefficient on the log of personal income variable—the coefficient's value, when a statistical technique (regression) is used, yields the long run elasticity of the tax base with respect to personal income. This is the statistic that economists use to measure revenue sufficiency.
- e_t is a random error term

The utility of this statistic is not just its single measurement value but its use in comparing tax bases among states and comparing the tax sufficiency of different taxes within a state.

We used the formulation above and applied a statistical regression technique to calculate the long term elasticity of the New York State's sales tax base with respect to personal income over the period 1990-2011. The statistical results from the regression provide that the value of the coefficient on the log of personal income variable is .78; its value is statistically significant at the 99 percent confidence level—a strong correlation.[44] This is the long run income elasticity of the sales tax base and the metric used to measure its revenue sufficiency.

Using this coefficient, we can estimate that, during 1990-2011, if the State's personal income grows 10 percent the sales tax base should grow, on average, 7.8 percent. As indicated above, this is an important statistic for policy makers to understand because public expenditures usually grow at least as fast as the State's economy over time and it is desirable for tax revenues to keep pace. Therefore, the desired long run elasticity for a tax base is somewhere close to 1, indicating that movements in the tax base should track the economy over time.

With this statistic, we can also compare the long run elasticity of New York State's sales tax base with the US median state's sales tax base elasticity with respect to the median state's income. Mikesell (2012) provides this median state statistic as .98; it is calculated using the same model and regression technique we used for New York but with data over a 40 year time period (1970- 2011) versus the 22- year period we used. This comparison indicates that the long run elasticity of the US median state's sales tax base, much more closely tracks the economy than New York's sales tax base. To demonstrate, if the median state's personal income grows 10 percent over time this is correlated with median state sale tax base growth of 9.8 percent; this compares with sales tax base growth of 7.8 percent for a 10 percent growth in New York State personal income.

Revenue Stability (Short-Run Income Elasticity)

Moving beyond visual observation, there is an empirical method available to examine how well the State's sales tax base is performing from a short run revenue stability perspective. To measure the rate of a change in the tax base with respect to the economy in the short term, public finance economists have settled on a common technique that produces a single statistic (metric) that policy makers can use to evaluate the revenue volatility of a tax or tax system. This metric is the short run elasticity of the state's tax base with respect to its personal income (a proxy for the economy).

[44] The full statistical results are available for interested readers

Economists have used an econometric technique to calculate this elasticity statistic. The equation is expressed in logarithmic form with an error correction mechanism:[45]

Equation 2:

$$Log(Sales\ Tax\ Base)_t - Log(Sales\ Tax\ Base)_{t-1}$$

$$= \mathbf{a} + \mathbf{b}\ [Log(Personal\ Income)_t - Log(Personal\ Income)_{t-1}] + \mathbf{c}\ e_{t-1} + e_t$$

Where:

- the dependent variable is the difference in the log of the sales tax base at time t versus its value at period (t-1)
- the independent variable is the difference in the log of the personal income at time t versus its value at period (t-1)
- **a** is an intercept term
- **b** is the coefficient on the difference in log of personal income variable—the coefficient's value, when a statistical technique (regression) is used, yields the short run elasticity of the tax base with respect to personal income. This is the statistic that economists use to measure revenue stability.
- **c** is the coefficient on the error correction term.

- e_{t-1} is the lagged value of the error term from the results of equation 1 above
- e_t is a random error term

Applying a statistical regression technique to the above formulation we calculated the short term elasticity of the State sales tax base with respect to personal income over the period 1991- 2011. Based on this analysis we found the coefficient's value on the difference in log of personal income variable is .83, with its value statistically significant at the 95 percent confidence level—a strong correlation.

Using this coefficient, we can estimate that, during periods of annual growth or contraction, if the State's personal income grows 10 percent the sales tax base should grow, on average, 8.3 percent. Conversely, if personal income contracts 10 percent the sales tax base should contract on average 8.3 percent. The desired short run elasticity for a tax base is somewhere slightly less than or equal to 1, indicating that movements in the tax base should track fairly closely with the business cycle and not oscillate dramatically.

The short run elasticity appears quite low for New York's sales tax base compared with the desired level of slightly less than 1. While the response of the sales tax base during years of contraction is desirable in that the tax base will decline on average less than personal income, during growth years the base will not respond as well to income increases.

[45] The logarithm referenced here is the natural logarithm. The coefficient on the error correction term captures the impact of model variance attributable to long run equilibrium. For discussion of this model formulation see , for example, Sobel and Holcombe (1996) & Bruce, Fox & Tuttle (2006)

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NEW YORK STATE ESTATE TAX ISSUES AND POLICY OPTIONS

Prepared for the New York State Tax Reform and Fairness Commission

July 2013

Background

New York State Law

New York's estate tax, which provides an exemption of $1 million, is based on the federal estate tax law as it existed on July 22, 1998. It is a "pick-up" tax equal to the value of the state death credit available at that time (1% for adjusted taxable estates under $100,000 up to 16% for estates in excess of $10,040,000).

The federal government eliminated the state death credit in 2005 and instead provided a deduction for state death taxes paid. Because New York does not automatically conform to federal estate tax changes, the 2005 federal legislation did not directly impact New York's estate tax. Each year, nearly 5,000 estates are subject to the New York estate tax, generating approximately $1 billion in annual revenues. Large taxable estates over $10 million account for nearly 50 percent of total estate tax collections. New York repealed its gift tax in 2000.

The New Federal Estate Tax Provisions

On December 17, 2010, Congress enacted and the President signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("Act"), which imposed a new federal estate tax for individuals dying after December 31, 2009 and before January 1, 2013 with a top rate of 35 percent and an exemption level set at $5 million indexed through 2012. No estate tax was imposed for those dying in 2010.[1]

Legislation enacted in 2013 to address the "fiscal cliff" issues made permanent the indexed exclusion amount going forward and set the top tax rate at 40 percent for estates of decedents dying after December 31, 2012. The 2013 federal estate exemption is now $5.25 million.

The 2013 legislation also made significant changes to the federal gift tax. For gifts made after 2010, the gift tax was reunified with the estate tax, with a top gift tax rate of 40 percent and a $5 million (plus indexing) exemption amount. These changes, as discussed below, have significant implications for New York estate tax revenues.

[1] The law also gave estates of decedents dying in 2010 an option to file a federal estate tax return using the new 35 percent top rate schedule and $5 million exemption amount. This option allowed estates to transfer assets using a stepped-up basis. If these estates did not elect this option, no tax was imposed and assets were transferred using the modified carryover basis rules in effect for 2010 estates under old law. The Act also extended the due date for filing a 2010 federal estate tax return and making a payment of federal estate tax until September 19, 2011.

Other States

New York is one of just 14 states with an estate tax, although four other states (Iowa, Kentucky, Pennsylvania, and Tennessee) have an inheritance tax. The table below summarizes the current exemption threshold in these states' estate taxes.

2013 State Estate Taxes

State	Exemption
Connecticut	$2 million
Delaware	$5.25 million
Hawaii	$5.25 million
Illinois	$4 million
Maine	$2 million
Maryland	$1 million
Massachusetts	$1 million
Minnesota	$1 million*
New Jersey	$675,000
New York	$1 million
Oregon	$1 million
Rhode Island	$910,725
Vermont	$2.75 million
Washington	$2 million

* Minnesota also has a deduction up to $4 million for qualified farm and small business property

New York Estate Tax Issues

Indirect Impact of Federal Law on New York Estate Tax Revenues

The new $5.25 million federal gift tax exemption raises an issue of significant concern regarding State estate tax revenues. Because New York has no gift tax, it was anticipated that wealthy individuals were likely to increase their gifting to minimize their New York estate taxes while their federal estate/gift tax liability remained unchanged. This conjecture was echoed by discussions Tax Department staff had with various estate tax practitioners. Any increase in gifting driven by the new federal exemption level would result in a reduction in the size of New York taxable estates, with a corresponding loss of estate tax revenue.

Although it is difficult to measure with precision, a loss in annual revenue was anticipated following the federal changes. While there is evidence that gifting has been on the upswing, collections of the New York estate tax have not exhibited a substantial decline to date. It is difficult to determine whether the federal changes have diminished what would otherwise have been higher revenues or whether the impact has been less than expected.

There are several policy options available that would mitigate a loss of revenue. One option would be to restore the New York gift tax, which would authorize the State to tax gifts above $1 million at the unified estate/gift tax rates. This would prevent the loss of revenue from any increased gifting of amounts in excess of $1 million. Another option would be to require the add-back of all gift amounts in excess of $1 million to the taxpayer's federal taxable estate for New York estate tax purposes. This would cushion, though not entirely eliminate, the loss of revenue from increased gifting above $1 million.

The Question of Outmigration

There has been speculation from various quarters that the periodic increases in the federal exemption amount from $1 million in 2003 to $5.25 million in 2013 (while the New York exemption has remained at $1 million) has led high-wealth taxpayers to move out of the State. While it is difficult to assess the impact of the New York estate tax on outmigration, the number of taxable estates and levels of estate tax revenues collected by New York since 2003 have not shown the declines that would lend support to this speculation. While the number of taxpayers and amounts of tax collected from high value estates remitting over $500,000 in liability can fluctuate based on economic and demographic factors, collections from this group have remained strong since 2008 when the tracking of these estates began.

The following table presents the historical collections from the New York estate and gift taxes since SFY 1997-98.

New York Estate & Gift Tax Net Collections (Millions of Dollars)			
SFY	*Estate Tax*	*Gift Tax*	*Total*
1997-98	$919.4	$102.8	$1,022.2
1998-99	$946.4	$125.0	$1,071.5
1999-00	$975.2	$79.5	$1,054.7
2000-01	$717.1	$41.4	$758.5
2001-02	$761.4	$6.3	$767.7
2002-03	$701.0	$7.0	$708.0
2003-04	$732.3	$3.7	$736.0
2004-05	$895.3	$3.2	$898.5
2005-06	$854.8	$2.0	$856.8
2006-07	$1,063.3	-$10.0	$1,053.4
2007-08	$1,036.7	$0.9	$1,037.5
2008-09	$1,162.6	$2.7	$1,165.2
2009-10	$864.0	$2.4	$866.4
2010-11	$1,218.1	$1.2	$1,219.2
2011-12	$1,078.4	$0.1	$1,078.5
2012-13	$1,014.0	$0.8	$1,014.9

In addition to the cost of living, which includes tax burden, the decision to live out one's life in a particular state or leave for another location is impacted by a number of factors, including the quality of health care, environmental quality, availability of outdoor recreation, cultural opportunities and proximity to family. Migration studies regarding the impact of taxes such as the estate tax have shown that taxes generally are not a major factor in the decision of where to live or retire.

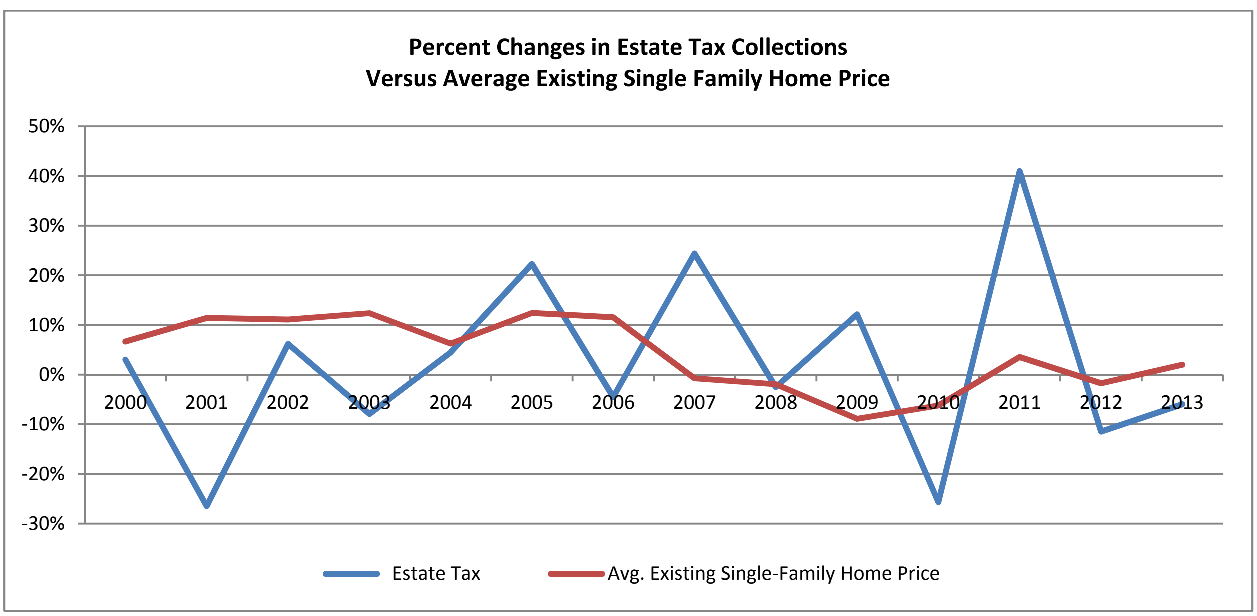
Although taxes are rarely cited by individuals as motivating factors by moving households, policy makers and researchers are nevertheless interested in the impact of taxes on migration. There are a number of studies that explore the impacts of taxes on the migration behavior of households in the United States. These papers generally show that taxes have relatively little impact on cross-state migration and estate tax revenues.

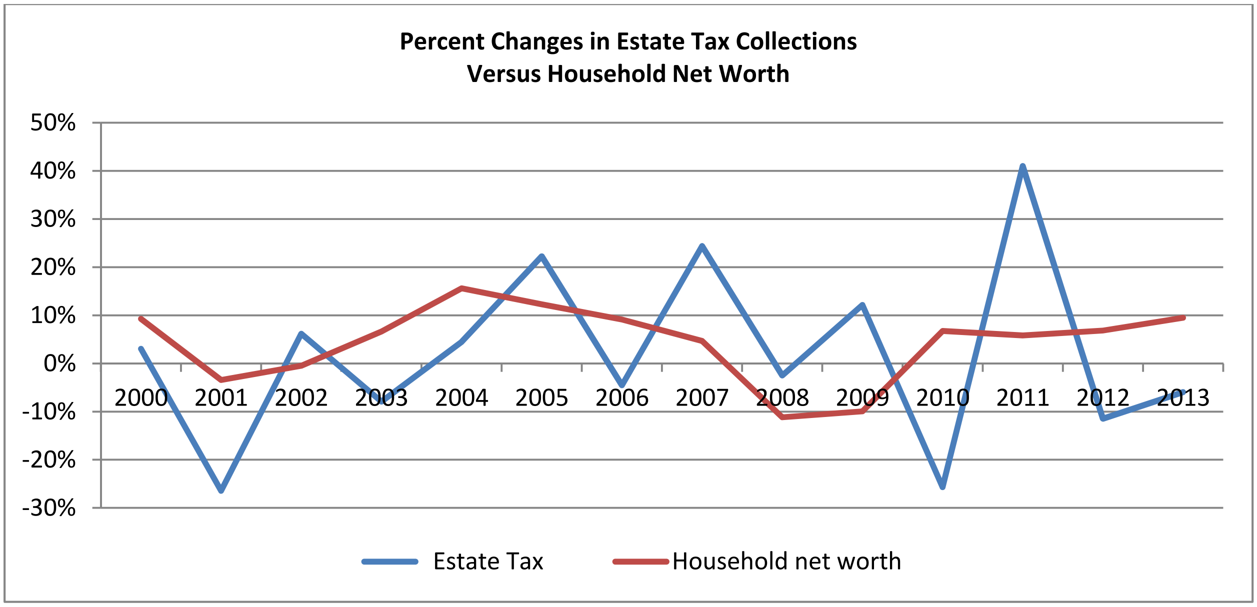
For example, Bakija and Slemrod (NBER Working Paper, 2004) use 18 years of data on the number of federal estate tax returns filed, sorted by wealth category by state, to study the impacts of state-level estate, inheritance, and gift (EIG) taxes. They find that states with EIG taxes report fewer federal estate tax returns. Migration is not measured directly, but the decrease in the number of estate tax filings is suggestive of location changes by wealthy households to avoid paying the state-level tax. The tax revenue lost by the states because of this migration, however, is very small compared to the revenues generated by maintaining the EIG taxes.

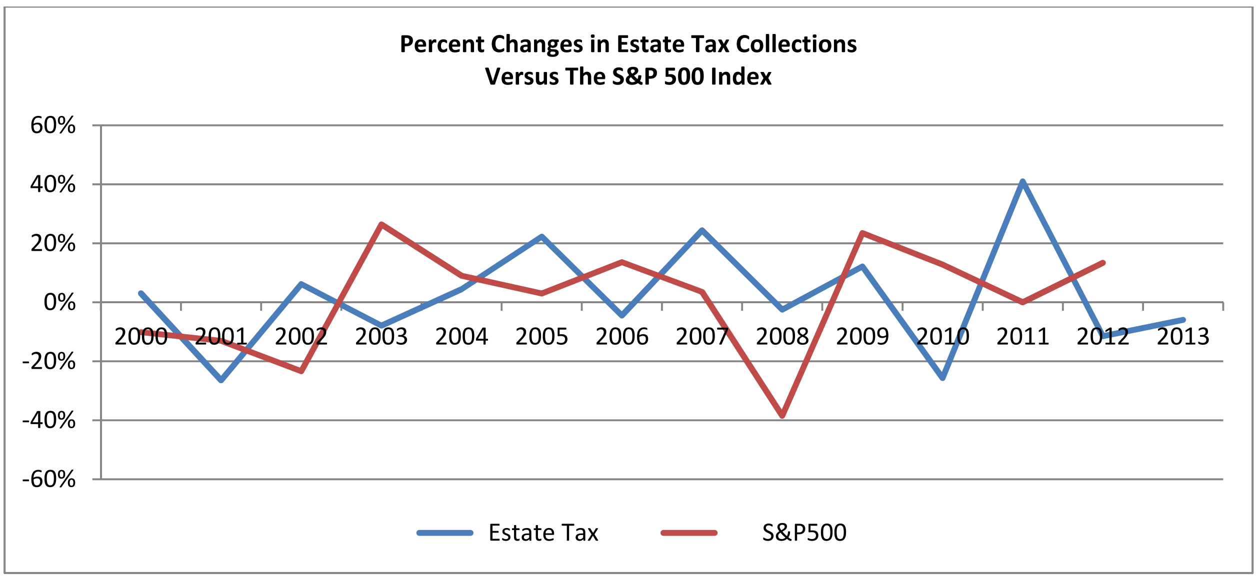
Conway and Rork (National Tax Journal, 2006) explore a similar question, constructing a state-level panel using data from the last four decennial censuses and directly measuring the migration patterns of elderly households following changes in EIG taxes. Their study finds no impact of state EIG taxes on migration of the elderly. Correlation between the presence of large numbers of elderly households and the absence of state EIG taxes, in Florida for example, is more likely a result of the development of powerful voting blocs that successfully push to eliminate those taxes in the state. The migration, in other words, was happening before the tax change and has continued since.

The level of estate tax collections are strongly related to various indicators of asset values, including those measuring the value of equities, property value, and household net worth. The following charts illustrate how estate tax collections have trended historically versus some of these indicators.

As shown by the charts, the percent change in estate tax collections since 2000 has trended relatively close to percent changes in average existing single family home prices, household net worth, and the S&P 500 index. These are some of the significant variables used by the Division of the Budget in models used to forecast estate tax revenues for the State financial plan. Movements in stock and real estate values are especially significant components of large estates, which account for the bulk of the tax remittances. When viewing these charts, it is important to keep in mind that estate tax collections generally lag these estate value indicators by up to one year, since the assets are valued at the date of death and the returns and payments are due nine months later. As a result, changes in the indicators are often reflected in similar changes to tax collections in the next year.







Policy Options

There have been a number of proposals over the years to reform the New York estate tax. The main concern has been with regard to the relatively low taxable estate exemption amount of $1 million. The last year in which the federal and state exemption amounts were the same (at $1 million) was 2001. Over the last dozen years, the federal government has periodically increased its exemption, with the exemption amount now $5.25 million with annual indexing. This has resulted in an ever growing number of estates that are exempt from federal estate tax but have a New York State liability. Moreover, where a $1 million estate may have at one time been considered an indication of considerable wealth, increases in real property values, in combination with other assets, have resulted in taxable estates for many middle-class households, especially downstate where real property values are higher than those found upstate. Each legislative session, bills are introduced that would increase the current $1 million exemption.

Another concern with the New York estate tax has been the perceived high rates of taxation under the estate tax, which currently range from approximately 1 percent for adjusted taxable estates under $100,000 to 16 percent for estates in excess of $10,040,000. The top rate results in large tax payments from those estates subject to this rate. To address this issue, legislation would be needed to lower these rates. The following section discusses these reform options in greater detail.

Increasing the Exemption Amount

The following table presents the revenue impact of increasing the New York estate tax exemption amount from $1 million currently to various levels up to $5 million. As indicated, increasing the exemption to the $5 million level, close to the 2013 federal exemption amount, would reduce the number of table estates by nearly 85%. Revenues, in turn, would be reduced by 37%, or approximately $385 million based on SFY 2011-12 returns filed.

Revenue Impact of Increasing Unified Exemption
Based on SFY11-12 Final ET-706 Returns Filed

Unified Threshold	*# No Tax*	*% Reduction in Taxable #*	*Revenue Loss (Millions $)*	*% Reduction in Tax Liability*
$1.5m	1,499	35%	$65	6%
$2 m	2,391	55%	$135	13%
$2.5 m	2,787	64%	$185	18%
$3 m	3,182	73%	$235	22%
$3.5 m	3,371	78%	$274	26%
$4 m	3,560	82%	$313	30%
$4.5 m	3,679	85%	$349	33%
$5 m	3,797	88%	$385	37%

While increasing the exemption amount provides tax relief to a great number of taxpayers currently subject to the estate tax, taxpayers above any given exemption threshold do not benefit from the increase in exemption level.

Reducing the Top Rate

As mentioned previously, New York's estate tax is based on the federal estate tax law as it existed on July 22, 1998. The New York estate tax is a "pick-up" tax equal to the value of the state death credit which existed at that time. The tax table to determine the credit ranges from approximately 1 percent for adjusted taxable estates under $100,000 to 16 percent for estates valued at over $10,040,000.

The table below presents a distribution of estate taxpayers by taxable estate class for ET-706 returns filed during the 2011-12 fiscal year. As the table shows, there were 168 federal taxable estates greater than $10 million that paid $509 million, or nearly half of the entire amount of liability reported on ET-706 returns filed during the fiscal year. Based on these figures, there would be a $30 million reduction in liability in the "over $10 million" estate class for each one percent decrease in the top rate of 16 percent.

New York State Estate Tax
SFY 2011-12

Federal Taxable Estate	*# Estates*	*Tax Liability (thousands $)*
Nontaxable Estates	2,540	0
$ 0 - $ 675,000	24	264
675,000 - 700,000	5	51
700,000 - 800,000	10	202
800,000 - 900,000	17	403
900,000 - 1,000,000	17	514
1,000,000 - 1,250,000	831	26,743
1,250,000 - 1,500,000	668	36,284
1,500,000 - 2,000,000	892	68,599
2,000,000 - 3,000,000	791	99,072
3,000,000 - 4,000,000	378	77,095
4,000,000 - 5,000,000	237	72,225
5,000,000 - 6,000,000	131	51,342
6,000,000 - 7,000,000	52	27,592
7,000,000 - 8,000,000	56	33,722
8,000,000 - 9,000,000	39	28,055
9,000,000 - 10,000,000	21	17,302
Greater than 10,000,000	168	508,554
Total	6,877	$1,048,019

AN EVALUATION OF NEW YORK STATE'S PERSONAL INCOME TAX

Prepared for the New York State Tax Reform and Fairness Commission

June 2013

I. Background

A. Overview of Current New York State Structure

1. Tax Base

New York State's income tax is imposed on the entire income of New York residents, and on the New York-source income of nonresidents. The computation of tax starts from federal adjusted gross income (FAGI). Certain items of income not subject to federal tax are taxed by New York, while other items of income subject to federal tax are not taxed by New York. These are addition and subtraction modifications to FAGI. In 2012, there were 31 addition modifications and 43 subtraction modifications. For example, taxpayers must add back interest on bonds issued by other states and their localities, which are exempt from federal tax but taxable for New York purposes.

Some of the more significant subtraction modifications include U.S. government bond interest, federally taxable social security benefits, all federal, New York State and local governmental pension income, and up to $20,000 of qualifying private pension and annuity income. Also, individuals may subtract from FAGI up to $5,000 per year of contributions made under the New York State College Choice Tuition Savings Program. The netting of these additions and subtractions results in New York Adjusted Gross Income (NYAGI).

Taxpayers may choose either the New York standard deduction or New York itemized deductions. Taxpayers using the federal standard deduction, however, must use the New York standard deduction. For 2013, the New York standard deduction is:

Table 1: 2013 Standard Deductions

Married Filing Jointly	$15,400
Head of Households	$10,800
Single Individuals	$7,700
Married Filing Separately	$7,700
Dependent Filers*	$3,050
* Those claimed as a dependent on someone else's return.	

In 2013 through 2017, the amounts of the standard deduction will be indexed for inflation.

Taxpayers who itemize federal deductions may itemize deductions for New York. Taxpayers use their federal itemized deductions as the starting point for calculating their New York itemized deductions. Certain adjustments are then required. The most common are the disallowance of state and local income taxes paid and the allowance of deductions for expenses incurred to carry other states' bonds.

Taxpayers may claim an itemized deduction for college tuition expenses paid on behalf of the taxpayer, the taxpayer's spouse, or their dependents to enroll or attend qualifying in- or out-of-state institutions of higher education. The deduction is available only for undergraduate study. Taxpayers may choose between the itemized deduction and a 4 percent refundable credit (described in more detail below).

New York limits the itemized deductions of upper-income taxpayers through a percentage reduction. The limitation begins at 25 percent of deductions for single taxpayers with NYAGI over $100,000 and married taxpayers with NYAGI over $200,000, and reaches 50 percent of itemized deductions for all taxpayers with New York adjusted gross income above $525,000 and below

$1 million. Itemized deductions are completely eliminated, except for 50 percent of charitable contributions, for taxpayers with more than $1 million of NYAGI. For tax years 2010 through 2015, only 25 percent of charitable contributions are allowed for taxpayers with more than $10 million of NYAGI.

Taxpayers with dependents are allowed an exemption of $1,000 for each dependent who qualifies for a federal personal exemption. The exemption does not apply to taxpayers and their spouses, including dependents filing their own tax returns.

New York AGI less deductions (either standard or itemized) less dependent exemptions equals New York taxable income. New York taxable income is the base of the personal income tax to which the rate structure is then applied.

2. *Tax Rates & Brackets*

After computation of taxable income, tax before credit is computed by applying the marginal tax brackets and supplemental tax, if applicable, as described below.

For tax years 2012 through 2017, New York has temporarily created additional income tax rates and brackets. New York currently imposes a graduated income tax with rates ranging between 4 and 8.82 percent of taxable income. For tax years 2013 through 2017, the dollar amounts in the tax tables are indexed by a cost of living percentage adjustment. The rate schedules for tax year 2013 are shown below:

Table 2: 2013 New York State Personal Income Tax Rates

Married Filing Jointly	
Taxable Income	Tax
Not over $16,450	4.00% of taxable Income
Over $16,450 but not over $22,600	$ 658 plus 4.50% of excess over $16,450
Over $22,600 but not over $26,750	$ 935 plus 5.25% of excess over $22,600
Over $26,750 but not over $41,150	$ 1,153 plus 5.90% of excess over $26,750
Over $41,150 but not over $154,350	$ 2,002 plus 6.45% of excess over $41,150
Over $154,350 but not over $308,750	$ 9,304 plus 6.65% of excess over $154,350
Over $308,750 but not over $2,058,550	$ 19,751 plus 6.85% of excess over $308,750
Over $2,058,550	$139,433 plus 8.82% of excess over $2,058,550
Single, Married Filing Separately, Estates and Trusts	
Taxable Income	Tax
Not over $8,200	4.00% of taxable Income
Over $ 8,200 but not over $11,300	$ 328 plus 4.50% of excess over $ 8,200
Over $11,300 but not over $13,350	$ 468 plus 5.25% of excess over $11,300
Over $13,350 but not over $20,550	$ 575 plus 5.90% of excess over $13,350
Over $20,550 but not over $77,150	$ 1,000 plus 6.45% of excess over $20,550
Over $77,150 but not over $205,850	$ 4,651 plus 6.65% of excess over $77,150
Over $205,850 but not over $1,029,250	$13,209 plus 6.85% of excess over $205,850
Over $1,029,250	$69,612 plus 8.82% of excess over $1,029,250
Head of Household	
Taxable Income	Tax
Not over $12,350	4.00% of taxable Income
Over $12,350 but not over $16,950	$ 494 plus 4.50% of excess over $12,350
Over $16,950 but not over $20,050	$ 701 plus 5.25% of excess over $16,950
Over $20,050 but not over $30,850	$ 864 plus 5.90% of excess over $20,050
Over $30,850 but not over $102,900	$ 1,501 plus 6.45% of excess over $30,850
Over $102,900 but not over $257,300	$ 6,148 plus 6.65% of excess over $102,900
Over $257,300 but not over $1,543,900	$ 16,416 plus 6.85% of excess over $257,300
Over $1,543,900	$104,548 plus 8.82% of excess over $1,543,900

3. *Supplemental Tax*

The Tax Law also includes a supplemental income tax for the purpose of recapturing the benefits conferred to taxpayers through tax brackets with rates lower than the maximum rate, which phases in over varying NYAGI ranges depending on filing status. The supplemental tax applies to all taxpayers with NYAGI over $100,000.

For married taxpayers filing jointly the recapture of rates below the 6.45 percent rate begins when NYAGI is $102,900 and is completed when NYAGI equals $152,900. The 6.65 percent rate is phased in when NYAGI is $154,350 and is completed when NYAGI equals $204,350. For all other filing statuses, once taxpayers' NYAGI exceeds $152,900, all of their taxable income within the 6.65 percent tax bracket becomes effectively subject to a flat 6.65 percent tax rate.

For taxpayers with taxable income in the 6.85 percent bracket, the recapture of rates below the 6.85 percent bracket begins when NYAGI is $308,750 for married filing joint taxpayers ($205,850 for single taxpayers and $257,300 for head of households) and is completed when NYAGI equals $358,750 ($255,850 for single taxpayers and $307,300 for head of households).

The recapture of rates below the 8.82 percent rate begins when NYAGI is $2,058,550 for married taxpayers filing jointly ($1,029,250 for singles, $1,543,900 for head of households) and is completed when NYAGI equals $2,108,550 ($1,079,250 for single taxpayers, $1,593,900 for head of households), with an overall limitation on tax liability equal to the highest tax rate multiplied by taxable income.

Thus, for tax year 2013 a flat rate of 8.82 percent of taxable income will apply for married taxpayers filing jointly with NYAGI in excess of $2,108,550 ($1,079,250 for single taxpayers and $1,593,900 for head of households). For tax years 2013 through 2017, the computation of the supplemental tax is indexed by a cost of living percentage adjustment.

4. *Credits*

After tax before credits is computed, taxpayers can reduce their liability further, or in some cases receive rebates from the State, through the use of various tax credits. The personal income tax contains 46 individual tax credits, some of which are designed to achieve social policy objectives while others are intended to promote economic development in the State. (The Appendix to this Report provides a comprehensive list of "tax expenditures" in the personal income tax along with estimates of their cost). Some of the more significant credits include:

<u>Household Credit</u>: The household credit (HHC) provides nonrefundable tax relief to taxpayers whose deductions and exemptions do not bring their taxable income to zero. The credit varies by income and filing status and increases for each additional exemption allowed for federal tax purposes. The value of the credit decreases as income rises, phasing down to zero at $28,000 of federal adjusted gross income (FAGI) for single taxpayers and $32,000 for all others.

<u>Real Property Tax Circuit Breaker Credit</u>: Qualified resident taxpayers may claim the refundable real property tax circuit breaker credit in an amount equal to 50 percent of excess real property taxes, determined according to the level of household gross income and subject to certain specified conditions and limits. Total household gross income cannot exceed $18,000. The maximum credit is $375 where at least one member of the household is age 65 or over, and $75 where all members of the household are under age 65. The amount of the credit decreases as household income increases.

<u>Child and Dependent Care Credit</u>: The New York child and dependent care credit is equal to various percentages of the corresponding federal credit. The credit equals 110 percent of the federal child and dependent care credit for taxpayers with incomes under $25,000. Percentages ranging from 110 percent to 20 percent apply for those with incomes from $25,000 to $65,000. Taxpayers with incomes over $65,000 receive 20 percent of the federal credit. The credit is refundable to resident taxpayers.

<u>Earned Income Tax Credit</u>: New York allows an earned income tax credit (EITC) equal to 30 percent of the corresponding federal credit. The credit is refundable to residents and part-year residents. The EITC varies with family size, is based on earnings, and phases out as income increases, as follows for tax year 2013:

Table 3: 2013 New York State Earned Income Tax Credit

Family Size	Max. Creditable Earnings	Federal Credit Rate	Max. State Credit	Income for Start of Phase-Out (MFJ)*	Others	Income Cut-Off (MFJ)*	Others
Taxpayers With 1 Child	$9,560	34%	$975	$22,870	$17,530	$43,210	$37,870
Taxpayers With 2 Children	$13,430	40%	$1,612	$22,870	$17,530	$48,378	$43,038
Taxpayers With 3 or More Children	$13,430	45%	$1,813	$22,870	$17,530	$51,567	$46,227
Taxpayers Age 25-64 Without Children	$6,370	7.65%	$146	$13,310	$7,970	$19,680	$14,340

Credit amounts and maximum incomes are indexed annually for inflation. Taxpayers must subtract any HHC used from their EITC. Taxpayers who do not use the EITC receive the full HHC.

Enhanced Earned Income Credit for Certain Non-custodial Parents: Certain noncustodial parents may claim an enhanced EITC in lieu of the regular State EITC. To qualify, claimants must be age 18 or over, must have a minor child with whom they do not reside, must have a child support order in effect for at least half the tax year, and must have made the required support payments. The enhanced EITC is equal to the greater of: 20 percent of the federal EITC that the taxpayer would otherwise be able to claim for one qualifying child as a custodial parent; or 2.5 times the federal EITC for taxpayers without qualifying children. The credit is available only to residents and is fully refundable. Unlike the regular EITC, there is no HHC offset.

Empire State Child Credit: Resident taxpayers may claim a refundable credit equal to the greater of: $100 times the number of children ages 4-16 who qualify for the federal child credit; or 33 percent of the allowed federal child credit for children ages 4-16.

Family Tax Relief Credit: Effective for tax years 2014-2016, qualified taxpayers are eligible for a $350 refundable tax credit. An eligible taxpayer is a resident: claiming one or more dependents under age 17; having NYAGI of at least $40,000 but no greater than $300,000;, and having tax less other credits greater than or equal to zero. Eligible taxpayers will receive an advance payment of the credit no later than October 15th of the tax year if they meet the eligibility requirements for the tax year two years prior.

College Tuition Credit: Resident taxpayers may claim a refundable credit for college tuition expenses paid on behalf of the taxpayer, the taxpayer's spouse, or dependents to enroll or attend qualifying in- or out-of-state institutions of higher education. Like the itemized deduction, the refundable credit is available only for undergraduate study. The maximum amount of qualified tuition expenses is $10,000 per student. For taxpayers with allowable expenses of $5,000 or more, the credit equals 4 percent of allowable tuition expenses. Taxpayers with expenses of less than $5,000 may claim a credit equal to the lesser of allowable tuition expenses or $200. Resident taxpayers must choose between either the credit or the itemized deduction described earlier.

Long-Term Care Insurance Credit: A credit for 20 percent of long-term care insurance premiums is allowed. Unused amounts may be carried forward to future tax years.

Resident Credit: Full-year and part-year residents may claim a credit for income taxes paid to other states and their political subdivisions or provinces of Canada.

Investment Credit: New York allows a 4 percent investment credit (7 percent for research and development property) for certain investments in qualifying property made by businesses whose income is taxed under the personal income tax. There is also an employment incentive credit tied to the investment credit available to these businesses.

Farmers' School Tax Credit: The agricultural school property tax credit provides a refundable credit for farmers with a phase-out of the credit for taxpayers with NYAGI in excess of $200,000. Taxpayers may subtract principal payments on farm indebtedness from NYAGI in order to calculate the income limitation.

Emerging Technology Company Credits: Tax credits are allowed for qualified emerging technology companies that invest in research and development in New York State. They include an employment credit and a capital credit.

Excelsior Jobs Program: The Excelsior Jobs Program replaces the Empire Zones Program as the primary economic development program in New York. Four new credits are offered in certain strategic industries. The credits include: capital investment, research and development costs, job creation, and real property taxes.

Empire State Film Production Credit: A refundable credit applies for qualified film production companies. The credit equals 30 percent of qualified production costs allowable beginning in the year that the film is completed. If the amount of the credit is under $1 million, it is claimed in the taxable year in which the film is completed. If the amount of the credit is at least $1 million but less than $5 million, then it must be claimed over a two-year period, with half the credit claimed each year. Lastly, if the amount of the credit is $5 million or more, it must be claimed over a three-year period, with one-third of the credit claimed each year. Productions such as documentaries, news programs, game shows, sports, soap operas, and adult entertainment do not qualify for the credit.

Other credits apply for:

- taxes on accumulation distributions;
- residential investments in solar electric generating equipment;
- investments in “green buildings;”
- purchases of defibrillators;
- employment of persons with disabilities;
- nursing home assessments paid directly by taxpayers;
- volunteer firemen and ambulance workers;
- special additional mortgage recording tax paid on certain mortgages;
- brownfield cleanup and redevelopment;
- security officer training;
- land conservation easements;
- low-income housing;
- purchases of clean heating fuels;
- companies that provide transportation to individuals with disabilities;
- rehabilitation of historic properties;

- historic homeownership rehabilitation;
- Empire State film post production;
- Empire State commercial production;
- biofuel production;
- economic transformation and facility redevelopment;
- employing at risk youth;
- the retention of strategic businesses and jobs directly impacted by an event that leads to an emergency declaration by the Governor;
- hiring a qualified veteran;
- minimum wage reimbursement; and
- alternative fuels and electric vehicle recharging property.

5. *Minimum Tax*

A six percent minimum tax applies to certain federal tax preferences. Taxpayers subject to the minimum tax pay this tax in addition to the regular income tax. The law permits a "specific deduction" equal to $5,000, and a deduction for regular income tax

6. *Business Taxpayers*

The personal income tax also applies, at the individual level, to persons receiving income from business entities in which they hold an interest. For example, while sole proprietorships do not pay an entity-level tax, they pay tax on their businesses' net earnings. Also, partnerships do not pay an entity-level tax (certain partnerships do pay a fee, described below). However, individual partners pay tax on their distributive share of the partnership's income. The same is true for shareholders of a subchapter S corporation; the shareholder pays tax on his or her pro rata share of net earnings from the corporation, while the entity is subject to minimum tax under Article 9-A.

New York law authorizes the formation of limited liability companies (LLCs) and limited liability partnerships (LLPs). The LLC/LLP statute borrows heavily from provisions of the New York Partnership Law and Business Corporation Law. The taxation of an LLC in New York as a partnership or corporation is determined by its tax treatment and the federal level. LLCs and LLPs, whether foreign or domestic, with New York source income must pay an annual filing fee based on their prior year's New York source gross income.

The LLC/LLP fee ranges from $25 for those with New York source gross income of $100,000 or less to $4,500 for LLCs with New York source gross income greater than $25 million. The annual filing fee imposed on LLCs and LLPs extends to general partnerships. However, general partnerships whose New York source gross income is less than $1 million dollars are exempt from the fee. Additionally, single-member LLCs, which are disregarded entities for Federal income tax purposes, are required to remit a filing fee of $25.

7. *Nonresident Taxpayers*

Nonresident individuals, estates and trusts pay New York State income tax to the extent they derive income from New York sources. A base tax is first computed using the same rates, exemptions, deductions, and most credits applicable to residents. Next, this base tax is multiplied by the ratio of New York source NYAGI to total NYAGI as a resident.

B. *New York City Income Tax*

1. *Tax Structure*

A tax is imposed on residents and part-year residents of the City. Using the same filing statuses as under the State income tax, the starting point is New York State taxable income, with rates for tax year 2013 ranging from 2.907 percent to 3.876 percent. The rates in Table 4 reflect the approximately 6 percent rate reduction offered to City residents under the STAR program (for all taxpayers with income below $500,000, and a partial reduction for taxpayers with incomes above $500,000.

Like the State tax, an add-on minimum tax applies to tax preferences subject to the State minimum tax, at a rate of 2.85 percent.

Table 4: 2013 New York City Personal Income Tax Rates

Married Filing Jointly	
Taxable Income	Tax
Not over $21,600	2.907% of taxable Income
Over $21,600 but not over $45,000	$ 628 plus 3.534% of excess over $21,600
Over $45,000 but not over $90,000	$ 1,455 plus 3.591% of excess over $45,000
Over $90,000 but not over $500,000	$ 3,071 plus 3.648% of excess over $90,000
Over $500,000	$18,028 plus 3.876% of excess over $500,000
Single, Married Filing Separately, Estates and Trusts	
Taxable Income	Tax
Not over $12,000	2.907% of taxable Income
Over $12,000 but not over $25,000	$ 349 plus 3.534% of excess over $12,000
Over $25,000 but not over $50,000	$ 808 plus 3.591% of excess over $25,000
Over $50,000 but not over $500,000	$ 1,706 plus 3.648% of excess over $50,000
Over $500,000	$18,122 plus 3.876% of excess over $500,000
Head of Household	
Taxable Income	Tax
Not over $14,400	2.907% of taxable Income
Over $14,400 but not over $30,000	$ 419 plus 3.534% of excess over $14,400
Over $30,000 but not over $60,000	$ 970 plus 3.591% of excess over $30,000
Over $60,000 but not over $500,000	$ 2,047 plus 3.648% of excess over $60,000
Over $500,000	$18,098 plus 3.876% of excess over $500,000

2. *Credits*

Similar to the State income tax, a nonrefundable household credit is allowed for low and moderate-income taxpayers. Also similar to State law, an earned income tax credit equal to 5 percent of the federal credit applies, though unlike the State credit, no household credit offset is required.

Also, a nonrefundable credit is allowed to sole proprietors and partners for between 100 percent and 23 percent (the credit declines as taxable income increases between $42,000 and $142,000) of the City's unincorporated business tax (UBT) that they paid as members of entities subject to the UBT.

In addition, a refundable credit is allowed to many New York City residents as part of the State's STAR program. If a taxpayer's federal adjusted gross income less IRA distributions is $250,000 or less, the credit equals $125 for married couples filing jointly, and $62.50 for all others.

New York City personal income taxpayers whose household gross income is not greater than $30,000 are allowed a refundable credit for qualified child care expenses for children under the age of four. The credit equals 75 percent of the amount of the New York State Child and Dependent Care Credit for taxpayers with household gross income of $25,000 or less and phases down to zero percent for taxpayers with income above $30,000.

The New York City income tax does not permit a credit for taxes paid to other jurisdictions.

C. City of Yonkers Income Tax Surcharge

Yonkers is authorized to impose a personal income tax on residents, and an earnings tax on its nonresidents with wage or self-employment income from working in Yonkers. For tax year 2013, the resident income tax equals 15 percent of the State tax liability after nonrefundable credits. The nonresident earnings tax equals 0.50 percent of wages and self-employment earnings, after an allowable exclusion of $3,000 that phases out when earnings exceed $30,000.

D. Income Tax History

New York State's personal income tax dates back to 1919, but the present system of federal conformity with respect to definitions of income and deductions did not begin until 1960. In 1961, after the transition, the top tax rate was 14 percent starting at $23,000 of taxable income. Top rates continued to rise to as high as 15.375 percent for a period during the early 1970's. In 1978, the income tax was bifurcated into separate taxes on earned income (e.g., wages and business income) and unearned income (e.g., interest, dividends, capital gains) with higher tax rates on unearned income. This structure continued until 1989.

With the financial crisis of the mid-1970's and the recession of the early 1980's behind them, policy makers began to see the income tax structure as in need of reform. The tax was scheduled to be reformed over a 3-year period from 1985-87 by reducing the top tax rates from 10 percent to 9 percent on earned income and from 14 percent to 13 percent on unearned income. There were also planned increases in the standard deduction and special rules to benefit married taxpayers, because at that time the income tax did not have separate tax tables by filing status.

The three-year phase in was interrupted in 1986 by the enactment of federal tax reform that broadened the tax base and lowered the tax rates of the federal income tax. New York gained revenue from this reform, as the federal base broadening provisions flowed through automatically to the State's base while the federal rate changes did not. This windfall from federal reform provided the impetus for New York's own tax reform in 1987, which lowered rates and increased the standard deduction over a 5-year period. The reform package also instituted separate rate schedules for married couples filing jointly. The objectives of these reforms were to improve tax fairness, simplify the tax structure, make the tax more competitive, and remove low-income New Yorkers from the tax rolls.

The economic recession of 1990 halted the 5-year phase-in of the State's tax reform after three years. The law remained frozen from 1990 to 1994, with the exception of three significant changes. First, New York automatically conformed to new federal limitations on itemized deductions that affected high-income taxpayers. Second, the supplemental tax, which recaptured the benefits of lower tax brackets for taxpayers with NYAGI over $100,000, was enacted. Finally, New York adopted a refundable earned income tax credit.

Beginning in 1995, New York embarked on a 3-year reduction in income taxes by reducing rates, stretching tax bracket widths, and increasing the standard deduction and the earned income tax credit. By 1997, New York's top tax rate stood at 6.85 percent starting at $40,000 of taxable income for married couples and $20,000 for single filers. This rate structure remained in place through 2002, during which time there were further increases in the standard deduction and the earned income tax credit and numerous new credits were enacted into law.

The recession of the early 2000's caused the State to temporarily add two new tax rates and brackets for tax years 2003 through 2005. The top rate increased to 7.7 percent for all taxpayers with taxable income in excess of $500,000. This new top bracket moved away from the 50/50 split between married and single filers in the existing tax tables. In addition, a new supplemental tax was implemented to recapture tax bracket benefits below the top 7.7 percent bracket.

In 2006, the tax structure reverted back to its 2002 levels, further enhancements were made to the standard deduction, and the Empire State Child Credit was enacted into law. The reversion to the 6.85 percent top rate proved short lived once the Great Recession began in 2008. Once again, temporary rates and brackets were created. This time the top rate was set at 8.97 percent, starting at taxable income in excess of $500,000 for all filers. As before, a supplemental tax accompanied this temporary rate structure, which remained in effect from 2009 through 2011.

Temporary legislation effective for tax years 2012 through 2017 created new tax brackets that provided tax relief to middle class taxpayers and a new top tax rate of 8.82 percent for married taxpayers with taxable income in excess of $2 million ($1 million for singles). New supplemental taxes were created for all of these new tax brackets. For the first time, tax bracket widths, supplemental tax phase-in ranges, and standard deduction amounts were indexed for inflation. As the law stands currently, in 2018 the income tax will revert back to its pre-2009 structure, except for the changes resulting from indexing from 2013 through 2017, which will be retained. Absent further legislation, the top rate would once again revert to 6.85 percent in 2018.

E. Income Tax Collections and Liability

New York State personal income tax data are reported in different ways. The most common statistic used is tax collections. Tax collections represent the actual payments received by the Tax Department during a reporting period. Collections come from multiple sources such as withholding, estimated payments, payments with returns and extensions, or from audit and compliance activities. Collections are also net of tax outflows such as refunds. Tax collections cover multiple tax years, including the current tax year and prior tax years. In State fiscal year 2012-13, the personal income tax generated $40.2 billion in net collections, while New York City income tax collections equaled $8.5 billion and the Yonkers tax $40.5 million. The Tax Department reports annual tax collections on its web site at the following address:

http://www.tax.ny.gov/research/stats/statistics/stat_fy_collections.htm

A second income tax reporting concept is tax liability, which is the amount of tax computed on timely filed tax returns for a particular tax year. It is the tax arrived at through the computation process described in the Overview of the Current Structure above. The Tax Department also produces annual liability studies for the income tax. In tax year 2010, the total State income tax liability for all returns (taxable and nontaxable; resident and nonresidents) equaled $34.8 billion. The annual income tax liability study may be found at:

http://www.tax.ny.gov/research/stats/stat_pit/analysis_of_personal_income_tax_returns.htm

Another way to think about these concepts is that liability applies for a particular tax year, while tax collections spread over multiple years. For example, tax year 2010 liability is computed on a tax return that is filed in 2011. The payments to meet tax year 2010 liability are made throughout 2010 through withholding or estimated payments. When the return is filed, the taxpayer computes his or her liability and associates the payments made to determine whether a refund is due or an additional payment needs to be made. Thus, the payments associated with a particular tax liability may spread over two years or more should a tax return become subject to an audit.

II. Evaluation

A. Requirements of "Good Tax Policy"

New York's tax system, like that of any other national, state or local tax regime, is an instrument of social and economic policy as well as a source of revenue to finance public expenditures. Ideas as to what constitutes a "good" tax system date back for centuries to economists and social thinkers such as Adam Smith. The classic public finance literature lists the following characteristics of a "good" tax structure. These include:

- ✓ Taxes should equitably distribute the tax burden;
- ✓ Taxes should be economically efficient;
- ✓ Taxes should be easy to administer and comply with;
- ✓ Taxes should generate adequate revenues, and they should be a predictable and stable source of revenue; and
- ✓ Taxes should promote economic development policies.

The next part of this report will examine in more detail each of these five tenets of a "good" tax structure and will evaluate how well the New York State personal income tax meets each of these criteria.

B. Equity

One of the major tenets of tax policy is that a tax should be fair. Fairness can be measured in two ways: horizontal equity and vertical equity. Horizontal equity refers to taxing equally those with equal ability to pay. Vertical equity means that those taxpayers with greater ability to pay should pay a higher percentage of their income in tax. Vertical equity is described in terms of progressivity or regressivity. A progressive tax refers to a tax structure where taxpayers pay a greater proportion of their income in tax as their income rises. Regressive taxes work in the opposite manner, with taxpayers at the bottom of the income distribution paying proportionately more tax than those at the top.

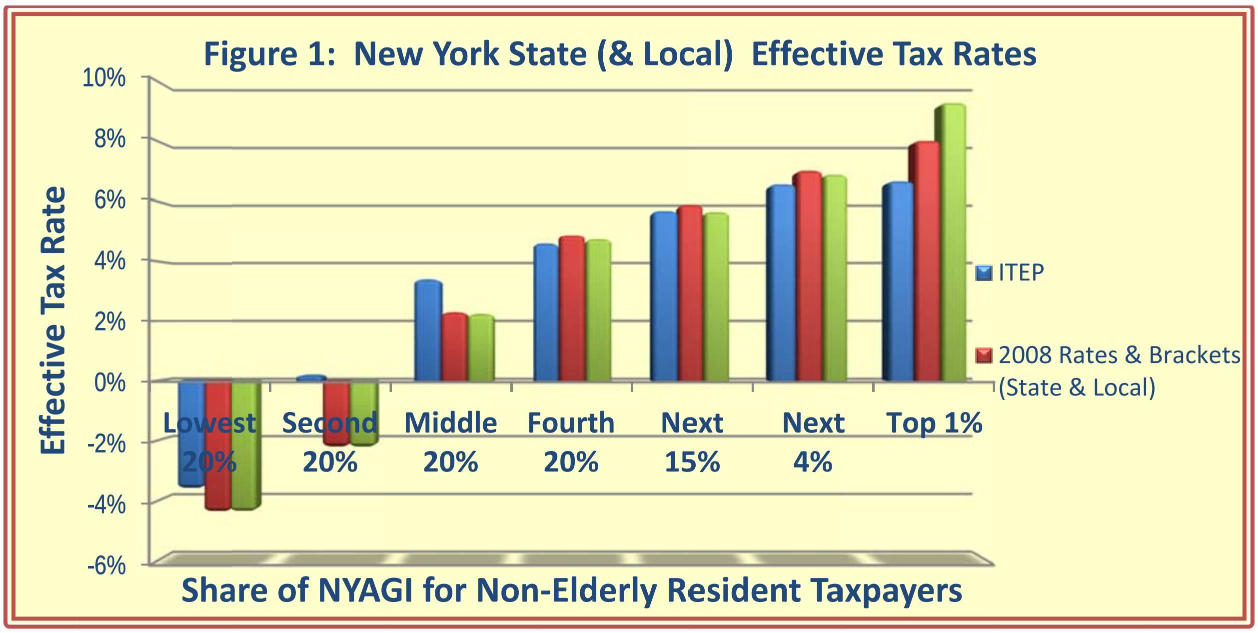
The personal income tax is generally considered to be a progressive tax. The Tax Department produced a companion study on the incidence of New York taxes using representative taxpayer profiles created from actual income tax data. The results of that study confirmed the progressive nature of the income tax.

The Tax Department has recreated the ITEP study for New York's State and local personal income taxes using its simulation model capabilities. The analysis uses both 2013 and 2008 personal income rates and brackets to draw comparisons to the ITEP results. In both instances, New York's personal income tax is shown to be highly progressive in nature. The results of the Tax Department simulation runs compared to the results from the ITEP study are depicted in Table 9.

Table 9: Comparison of New York State (& City) Effective Tax Rates for Non-Elderly Resident Taxpayers by Income Quintile

Personal Income Tax (State and Local) Analysis	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20% Next 15%	Top 20% Next 4%	Top 20% Top 1%
ITEP	-3.6%	0.2%	3.4%	4.6%	5.7%	6.6%	6.7%
Tax Department							
2008 Rates and Brackets	-4.4%	-2.2%	2.3%	4.9%	5.9%	7.1%	8.1%
Tax Department							
2013 Rates and Brackets	-4.4%	-2.2%	2.2%	4.7%	5.7%	6.9%	9.3%

Certain features within the New York personal income tax add to its progressivity. For instance, in addition to its graduated personal income tax rate structure in which tax rates increase as taxable income increases, New York also provides a high standard deduction, limits the availability of itemized deductions for certain high-income taxpayers, offers refundable credits for low-income taxpayers, and institutes a supplemental tax that recaptures the benefits of the lower tax brackets for certain high-income taxpayers. The combination of all these factors contributes to a highly progressive personal income tax as illustrated in Figure 1 below.



- ***Temporary High Rates***

  As noted earlier, for tax years 2012 through 2017, New York has temporarily created additional income tax rates and brackets with rates ranging between 4 and 8.82 percent of taxable income. The introduction of these additional rates adds to the progressivity of New York's personal income tax. For tax years beginning after 2005 and before 2009, New York had five income tax brackets with a top rate of 6.85 percent. Under current law there are now eight brackets with a top rate of 8.82 percent. The temporary additional rates include two marginal rates below the 6.85 percent rate (6.45 percent and 6.65 percent), in addition to the top rate of 8.82 percent. By decreasing the rates on lower levels of taxable income and increasing the rates on higher taxable incomes, New York's graduated personal income tax rate structure becomes more progressive.

For tax years beginning after 2017, the tax tables revert to the tax rates in effect in tax year 2008, and the top rate will again be 6.85 percent.

❖ ***Marginal Brackets***

The "stretching" of the marginal tax brackets corresponding with the temporary additional rates is also a contributing factor in the progressivity of the New York State personal income tax. For example, prior to 2009 the top marginal tax rate of 6.85 percent applied to all taxable income over $20,000 ($40,000 for married filing jointly). Therefore, someone with $80,000 in taxable income faced the same marginal tax rate on their last dollar of earnings as someone with $1 million of taxable income (i.e., 6.85 percent).

The temporary law now in effect between 2012 and 2017 introduced two additional brackets below the 6.85 percent rate (in addition to the top rate of 8.82 percent). Presently, taxpayers with taxable income between $20,000 and $75,000 ($40,000-$150,000 for married filing jointly) are taxed at a marginal rate of 6.45 percent, and taxpayers with taxable income between $75,000 and $200,000 ($150,000-$300,000 married filing joint) are taxed at a marginal rate of 6.65 percent, thereby reducing the effective tax rates of many middle-income New Yorkers. The top rate of 8.82 percent applies to taxable income above $1 million ($2 million for married filing jointly). Under current law, someone with $80,000 of taxable income pays 6.65 percent on their last dollar of earnings while the taxpayer with $1 million of taxable income pays 8.82 percent.

Another feature of the current personal income tax structure is indexing. For tax years 2013 through 2017, brackets in the tax tables will reflect a cost-of-living percentage adjustment. As a result, the marginal brackets "stretch" to keep pace with inflation.

❖ ***Standard Deduction***

The high level of New York's standard deduction also contributes to the progressivity of New York's personal income tax. Standard deductions ensure that all taxpayers have at least some income that is not subject to income tax. The amount of the standard deduction depends on the taxpayer's filing status. New York has one of the highest standard deductions in the country. In 2012 for example, single taxpayers and married taxpayers who file separate returns can claim a $7,500 standard deduction. Married couples filing jointly can claim an amount twice as large, $15,000, and taxpayers filing as head of household can claim a standard deduction of $10,500. This compares to the federal standard deduction of $5,950, $11,900, and $8,700, respectively. Data show that approximately 76 percent of New York taxpayers use the standard deduction, compared to 67 percent of federal taxpayers.

C. *Efficiency*

Taxes generally reduce economic efficiency because they distort economic decisions that would have been made absent the tax. For example, if a tax increases the price of a product, and a consumer purchases less of that product because of its higher price, the tax is said to have distorted the consumer's economic decision. The public finance literature suggests that a "good" tax system should minimize the economic distortions created by the imposition of a tax.

The personal income tax, like other taxes, diverts economic resources from private consumption and investment into the public arena. The public finance literature describes the excess burden or loss of efficiency of the income tax as caused by distortions in the choice between present consumption and future consumption (savings) or by distortions in the choice between work and leisure. The income tax favors present consumption over savings because items like interest are taxable.

However, an evaluation of the efficiency of New York's income tax is not limited to these textbook examples. The New York income tax contains numerous special tax breaks and incentives generally referred to as tax expenditures. The *Annual Report on New York State Tax Expenditures for the 2013-14 State Fiscal Year* lists 70 individual New York State income tax reductions from subtraction modifications, deductions and exemptions, and tax credits. These items are in addition to the dozens of other tax expenditures that automatically flow into the State income tax from the federal income tax.

These tax preferences have been added to the tax code over the years in order to encourage or reward certain taxpayer behaviors. Some of these incentives attempt to overcome shortcomings in the efficiency of the income tax discussed above. For example, the earned income tax credit is provided to the working poor as an encouragement to work, while the federal exclusion of IRA contributions from income is provided to encourage savings for retirement.

The literature suggests that the best method for minimizing economic inefficiencies in the income tax is to create the broadest possible tax base coupled with the lowest possible tax rates needed to achieve the desired revenue target. If the goal of income tax reform is to maximize economic efficiency, then the reform proposals should recommend both reductions in tax expenditures and lower tax rates than exist in the current system.

D. *Simplicity*

It is axiomatic that good tax administration is good tax policy. Or as Jean Baptiste Colbert observed: "The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing." Despite the fact that New York's personal income tax overwhelmingly relies upon taxpayers to voluntarily meet their tax obligations, the current personal income tax structure can be regarded as complex. The income tax form is four pages long and its instructions another 68 pages. In addition, there are separate schedules and instructions for itemized deductions and for the numerous tax credits that taxpayers may be eligible to claim on their return. The fact that over 80 percent of all returns filed used either a paid preparer or tax software to compute the taxpayer's liability is an indicator of the tax code's complexity.

❖ *Voluntary Compliance*

The overwhelming majority of New York's personal income tax – over 97 percent - is collected through voluntary compliance. Voluntary compliance is defined as the expectation that taxpayers will voluntarily pay the right amount of tax in a timely fashion. Accordingly, it is important that the tax system be as simple as possible in order to facilitate this form of compliance.

The Department of Taxation and Finance engages in a wide range of activities that directly or indirectly promote voluntary compliance, ranging from outreach activities that occur before the taxpayer begins to fill out a return to enforcement of the tax laws through criminal prosecution. Similarly, taxpayers' interactions with the Department cover a broad range of parallel activities, from following instructions and filling out forms through potential litigation and criminal defense.

Figure 2 below places the range of both Department and taxpayer activities on a *Compliance Continuum* that depicts these relationships:

Figure 2: The Compliance Continuum

Voluntary — **Involuntary**

DTF	Draft and negotiate tax legislation	Publish forms, instructions and guidance	Assist and educate taxpayers	Capture return data and process payments	Resolve exceptions	Issue bills and resolve protests	Audit	Collect	Litigate	Criminal enforcement
TAXPAYER	Review instructions	Ask questions	File returns and make exceptions	Answer questions arising from exceptions	Review bills	File protests	Undergo audit	Collection defense	Litigation defense	Criminal enforcement defense

More Taxpayers Impacted at Less Cost — **Fewer Taxpayers Impacted at Higher Cost**

❖ ***Federal Conformity***

Another key feature of the Tax Law that reduces the compliance burden on both taxpayers and the Department is federal conformity. Conformity allows taxpayers to transfer information from their federal return directly onto their State return, and it allows the Department to partner with the IRS in verifying tax compliance. Conformity takes three general forms: conformity of income; conformity of deductions; and conformity of tax credits.

Federal Adjusted Gross Income (FAGI) is the starting point for calculating New York State's personal income tax. However, there are currently nearly 80 deviations – additions and subtractions – that must be made to FAGI to calculate New York Adjusted Gross Income (NYAGI). Some of these are necessary to meet federal and New York State constitutional provisions, but most are by choice.

New York also conforms to most federal itemized deductions for State tax purposes. However, New York imposes its own limitations on these deductions on top of federal limitations. For the most affluent taxpayers, itemized deductions are not permitted, with the exception of a share of charitable contributions.

New York does not conform to most federal tax credits; however, there are several notable exceptions. The most significant is the earned income tax credit, under which New York provides credit equal to 30 percent of the federal credit (with some modifications). New York also uses the federal child and dependent care credit and the federal child credit as the starting points in determining the State versions of those credits.

❖ ***The Rise of Tax Expenditures***

New York State's personal income tax is far different today than it was as recently as 25 years ago. The main difference over time has been the rise of tax expenditures. Since 1990, the Department has published an annual mandated report that documents tax expenditure items under New York's major taxes, including the personal income tax.

The Executive Law defines tax expenditures as "…features of the Tax Law that by exemption, exclusion, deduction, allowance, credit, preferential tax rate, deferral, or other statutory device, reduce the amount of taxpayers' liabilities to the State by providing either economic incentives or tax relief to particular classes of persons or entities, to achieve a public purpose." The Appendix to this Report lists the tax expenditure items in the personal income tax and their revenue impact.

The change in the number of tax credits allowed taxpayers is a good measure of how tax expenditures – and the resultant tax complexity - have grown.

For example, in 1990 there were a total of 8 personal income tax credits. By 2013, this number had increased to 36. Each new tax expenditure item, per force, increases tax complexity. Most new tax expenditure items – particularly tax credits - require new forms, guidance and other related materials.

The increase in the number of tax expenditures comes from two general sources. Foremost are business-related tax credits. Since the 1990s, more and more businesses (many of them small businesses) have opted to structure their operations as Limited Liability Companies (LLCs) instead of "C" corporations. Owners of these businesses pay tax on their business income via the personal income tax. As a consequence, new tax credits for businesses were made available under the personal income tax as well as the Corporate Franchise Tax (Article 9-A of the Tax Law).

Second, over the same period, policy makers have often opted to provide financial support to achieve certain social goals through the tax code rather than through direct spending. Moreover, these types of tax credits are almost always refundable. That is, if the credit(s) exceed taxpayer liability, the excess is refunded to the taxpayer in the form of a cash rebate. This refundability feature poses additional administrative burdens on the Department. Refundable credits can result in large cash rebates, and therefore provide a tempting target for tax fraud. Significant additional resources must be devoted to "front-end" audits (before a check is sent to the taxpayer) to address this concern.

Table 10 shows the largest of these credits, the number of claimants, and their aggregate cost:

Table 10: Claimants and Aggregate Amount of Major Social Policy Credits, Tax Year 2012

New York State Tax Credit	Claimants	Amount ($000)
Earned Income Tax Credit	1,525,000	$940,000
Empire State Child Credit	1,595,000	694,000
College Tuition Credit*	769,000	248,000
Child & Dependent Care Credit	457,000	195,000
Enhanced State Earned Income Tax Credit for Certain Non-Custodial Parents	8,000	3,600
*Includes claimants of alternative college tuition itemized deduction.		

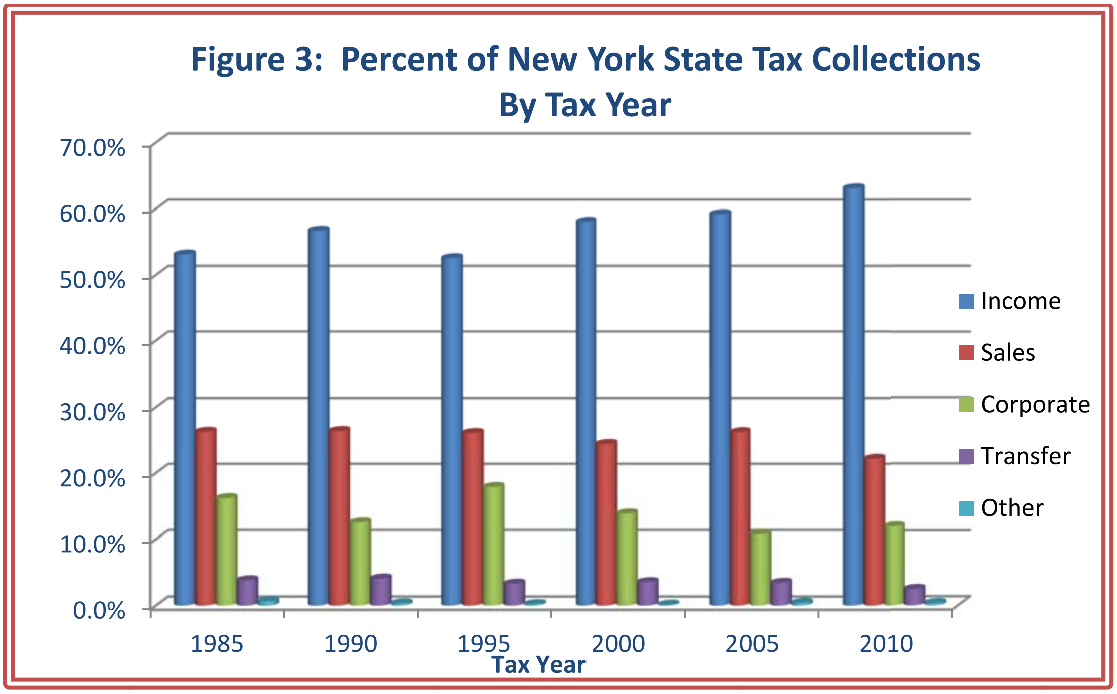
E. *Revenue Stability and Adequacy*

This section of the study addresses the questions of the adequacy, sufficiency, and stability of the New York income tax as a revenue source to fund expenditures for public goods and services in the State. An important characteristic of an effective tax as a revenue source is how well the tax performs in delivering a predictable flow of revenue over the long term while exhibiting minimal volatility with business cycles over the short term.

❖ *Significance of the Personal Income Tax*

The personal income tax is the most significant revenue source in New York State, accounting for nearly two-thirds of all tax collected. For SFY2011-12, the tax accounted for $38.8 billion, or 63 percent, of the $61.4 billion in total state tax collections (taxes administered by the Tax Department only). This figure is different from the percentage derived earlier in this report (53.3 percent – which is the amount of income tax collections as a percentage of total New York State tax collections) because the earlier table relies on data from the U.S. Bureau of the Census, and it includes state revenue sources that are not administered by the Tax Department such as motor vehicle fees, hunting and fishing licenses, and other assessments.

The importance of the tax in the overall mix of tax revenue to the State has risen since the mid-1980s. Figure 3 illustrates how the income tax has grown from 53.1 percent of total State revenues in tax year 1985 to 63.1 percent in tax year 2010.



While the income tax has increased as a percentage of total collections, the sales tax share of total collections decreased from 26 percent in 1985 to 22 percent in 2010. Similarly, the share of collections from corporation and business taxes declined from 16 to 12 percent over the same 25-year period. A portion of this decline is attributable to the rapid growth in limited liability companies since their introduction in New York State in 1994. This has resulted in an increase in the amount of business income subject to the income tax through these "flow-through" entities with an offsetting decline in the amount of business income taxable under the corporation tax.

❖ *Sources of the Personal Income Tax*

While the bulk of the New York State personal income tax is paid by full-year residents of the state, a sizable portion of the revenue is paid by full-year nonresidents and part-year residents of the State as well. A larger portion of the overall revenues comes from nonresidents compared to many other states because New York City draws many commuters from neighboring New Jersey and Connecticut. Table 11 presents the amount of tax liability reported on tax returns and the relative shares by full-year residents, nonresidents and part-year residents since 1995.

	Table 11: NYS Personal Income Tax Liability By Tax Year and Residency (Dollars in Billions)						
	Full-Year Residents		*Full Year Non-Residents*		*Part-Year Residents*		Total
Tax Year	Tax Liability	Percent	Tax Liability	Percent	Tax Liability	Percent	Tax Liability
2010	$29.0	83.1%	$5.4	15.3%	$0.5	1.5%	$34.9
2005	$23.9	83.4%	$4.2	14.8%	$0.5	1.7%	$28.6
2000	$21.0	85.1%	$3.2	12.9%	$0.5	2.0%	$24.7
1995	$14.0	87.1%	$1.8	11.4%	$0.2	1.5%	$16.0

The share of total income tax liability reported by nonresidents has increased from 11.4 percent in tax year 1995 to 15.3 percent in 2010, while the share reported by full-year residents has declined from 87.1 to 83.1 percent. Some of this change is a consequence of the number of highly paid executives and financial sector employees working in New York and commuting from neighboring states who realized significant wage gains over the period.

The distribution of full-year resident tax liability is not equally distributed across regions of New York State. In tax year 2010, approximately 3.6 million New York City residents paid $13.4 billion in State income tax. Another 2.2 million taxpayers in the remaining 7 downstate counties in the Metropolitan Commuter Transportation District (MCTD) contributed another $10.2 billion to the total. This includes the counties of Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk and Westchester. Approximately 2.8 million returns were filed by full-year residents in the remaining 50 upstate counties, and they accounted for just over $5 billion in tax liability.

Figure 4 details the percent of total income tax liability in these regions for the period 1993 to 2010.

Figure 4: Percent of New York State Full Year Resident Income Tax Liability By Region for Tax Years 1993-2010

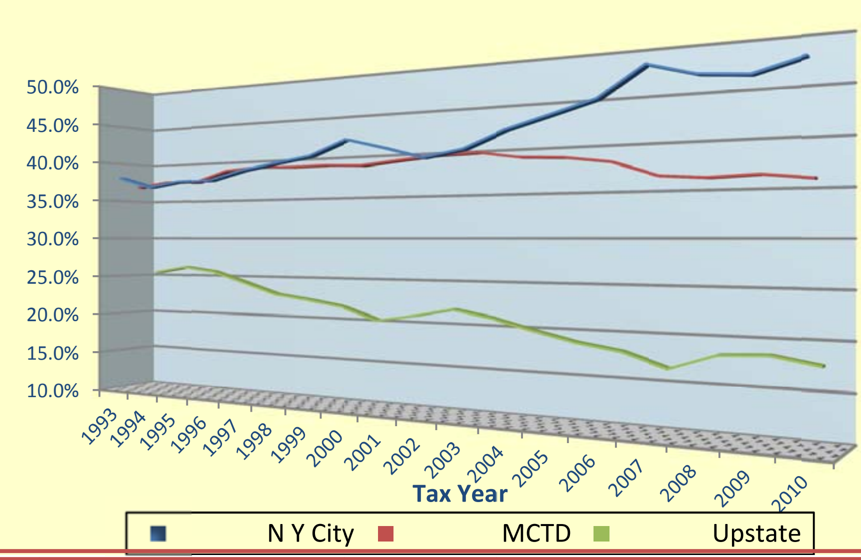


Figure 4 shows that the share of total income tax liability of full-year residents derived from New York City has steadily increased from 37.8 percent in 1993 to 46.7 percent in 2010. Conversely, the share of tax paid by other counties in the MCTD region and upstate have both exhibited a decline. The strength of the New York City economy compared to the relative softness in economic conditions in the rest of the state contributed to this trend of increasing reliance on the City for generating income tax revenues over this period.

The New York State income tax is coupled to the federal definition of adjusted gross income (FAGI) and its component parts. These various sources of income, as a percentage of total income, vary over time. This mix is important because some of these income sources show only incremental changes from year to year, and these contribute to the stability of the income tax as a revenue source. Other sources, however, are more volatile and cause more variation in the level of revenues over both long and short term time horizons.

Figures 5 through 8 illustrate the relative share of the various sources of income to total New York gross income since 1995. For nonresident taxpayers, these amounts represent federal source income (income from all sources both in and out of New York).

Figure 5: Income Sources - 1995

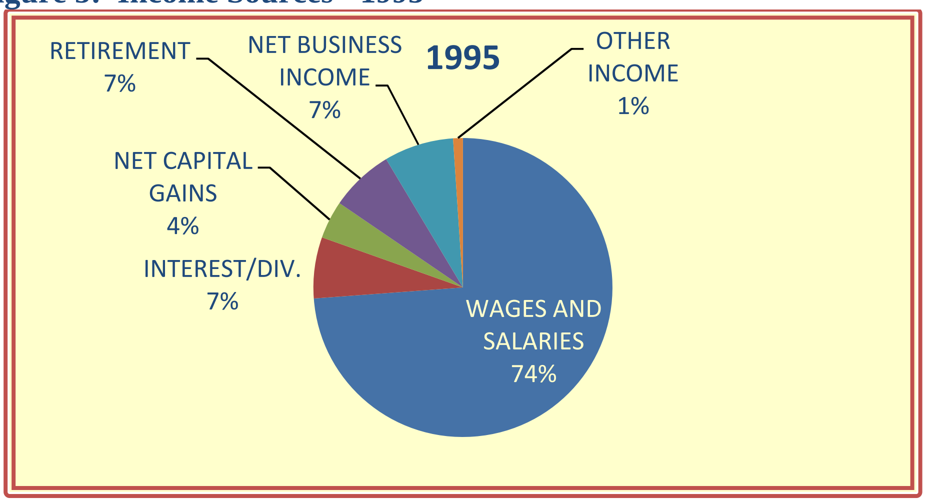


Figure 6: Income Sources - 2000

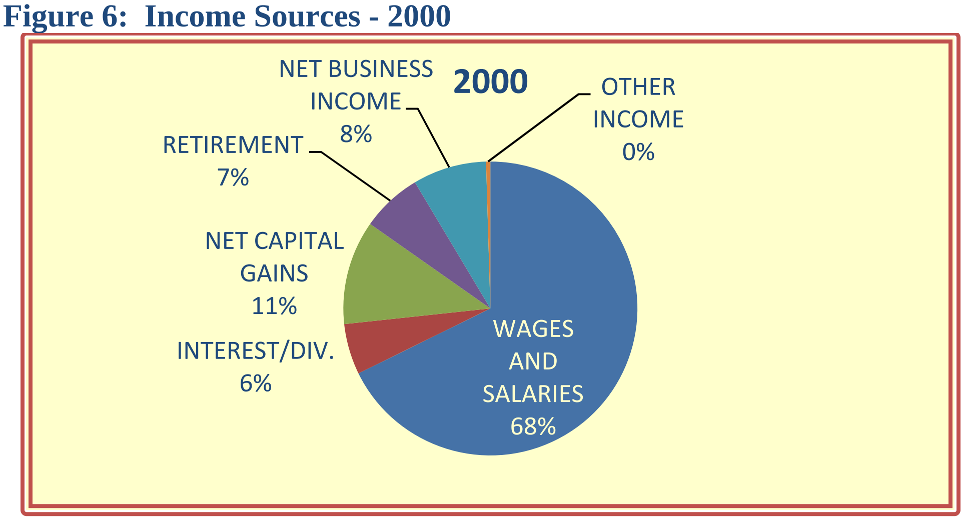


Figure 7: Income Sources - 2005

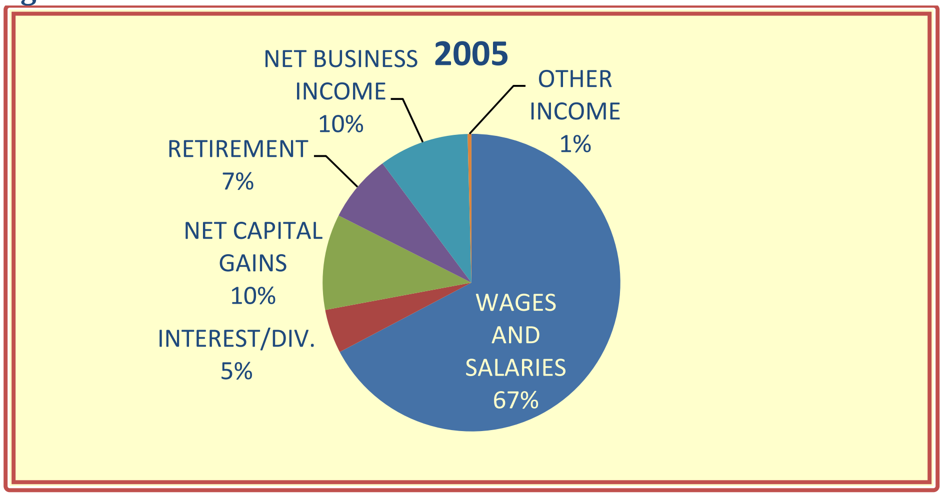
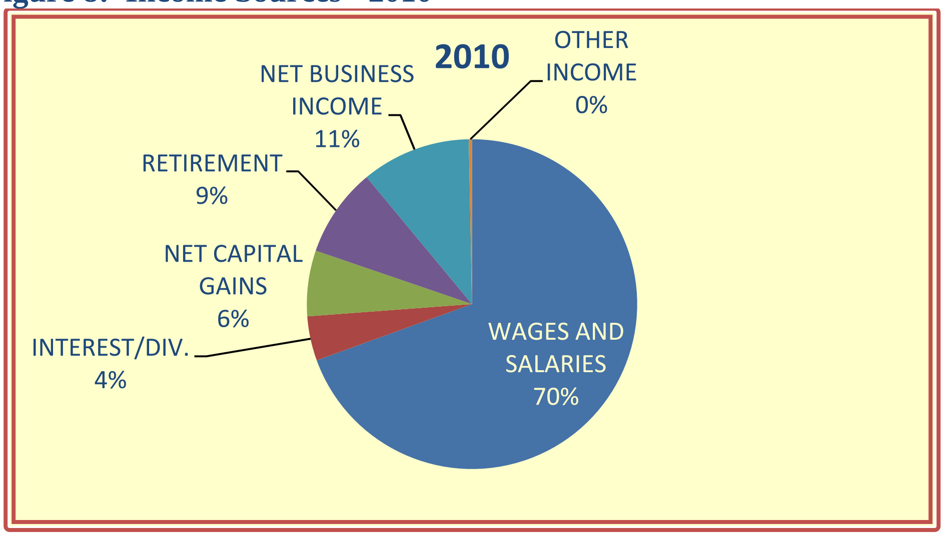


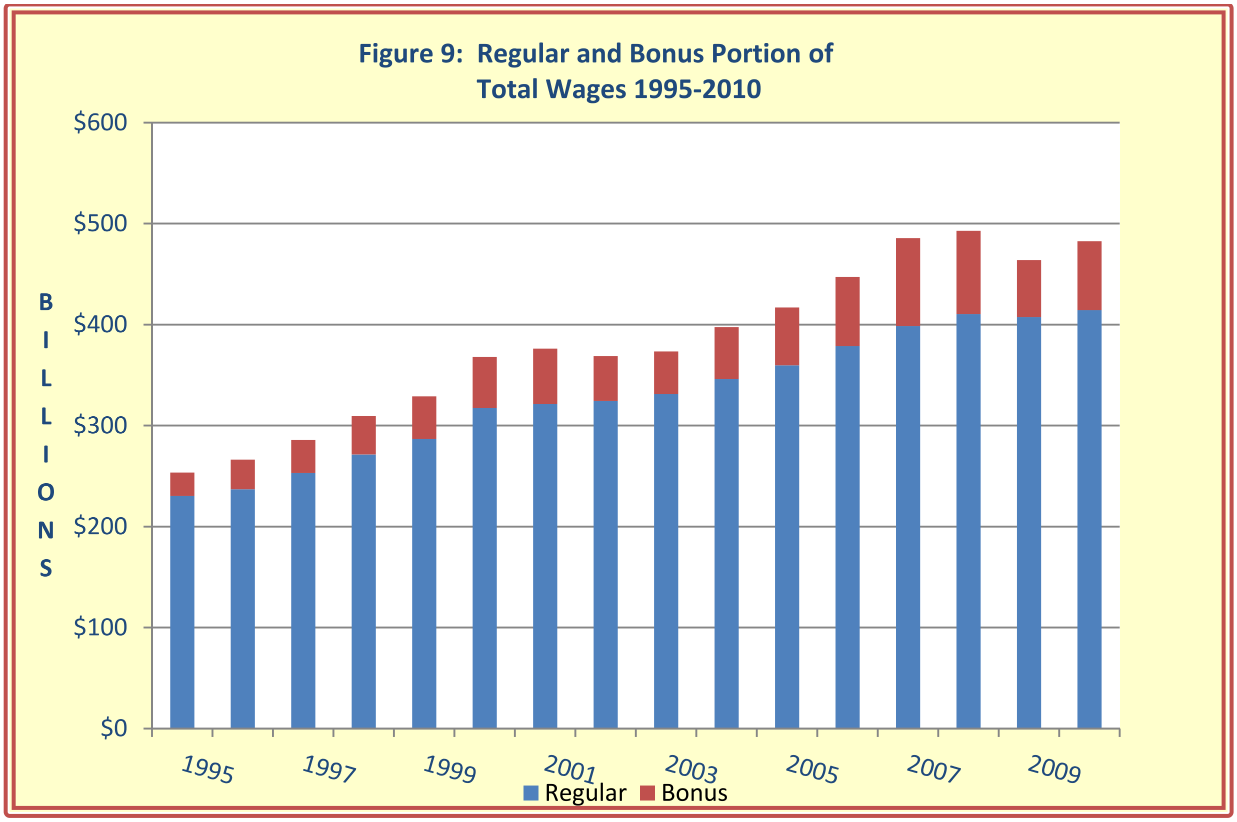
Figure 8: Income Sources - 2010



As these figures indicate, wages and salaries are the largest portion of gross income. This source has varied from 74 percent of all income in 1995 to 67 percent in 2005. It is interesting to note that in years when the economy is robust, such as in 2000 and 2005, wages shrink as a percentage of total income and the shares of capital gains and business income increase. While retirement income has remained fairly stable as a percentage of income over time, interest and dividends have exhibited a steady decline due to persistently low interest rates and stagnant corporate dividend payments.

One of the more volatile components of wages and salaries is bonuses paid to highly compensated employees. Most bonus compensation is subject to withholding, although changes in compensation practices has resulted in a larger share of bonuses granted in the form of stock options, which are not subject to withholding until they are exercised. Figure 9 illustrates the growth in total wages and the increase in the bonus portion of total wages over the period 1995 to 2010.[1] As the chart indicates, bonus compensation has grown significantly over this time frame. Furthermore, bonuses as a percentage of total wages have also increased. This is significant because bonus income has fluctuated substantially from year to year along with the performance of the financial services sector. Together, bonus income and capital gains have been the most volatile components in the income tax.

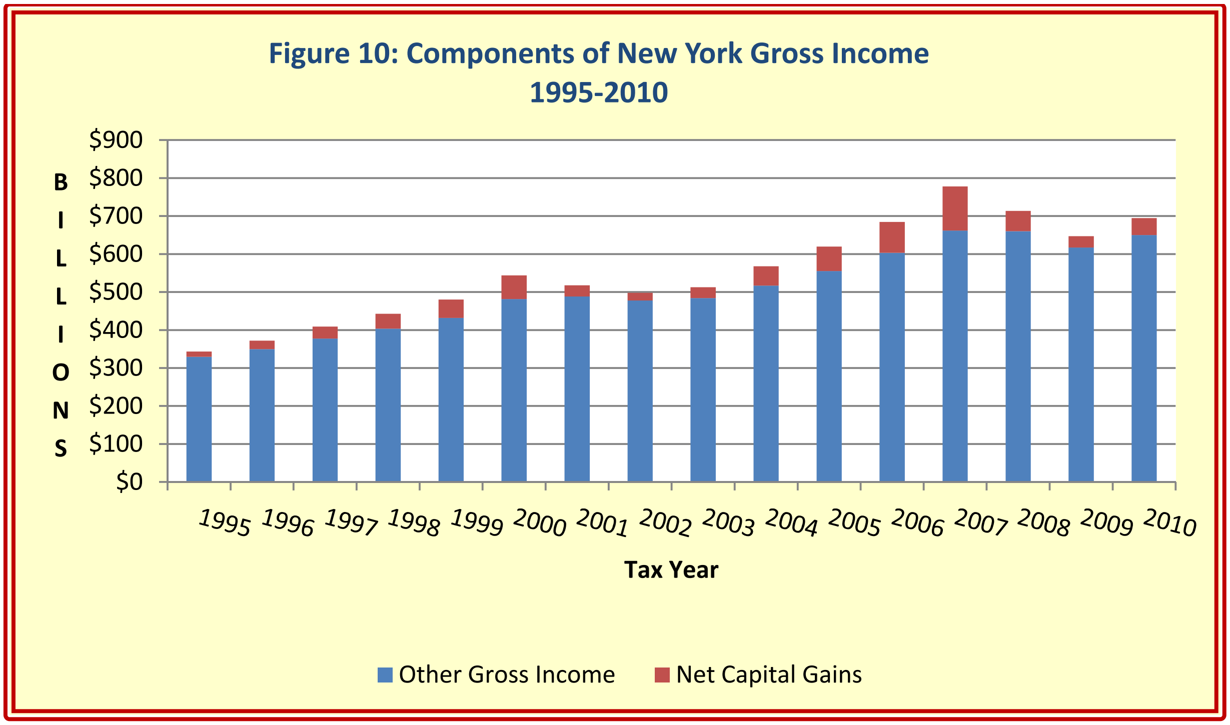
[1] There is no official bonus series; the bonus series referenced above has been constructed by the NYS Division of the Budget.



In 1995, taxable wage income totaled $254 billion with bonus income of $23 billion, or 10 percent of this total. By 2010, wages had grown to $482 billion with bonus income comprising $68 billion, or 16 percent of total taxable wages. Over the period 1995 to 2010, bonus income reached a high of $87 billion in 2007, or 22 percent of total wages.

Another volatile component in the New York income tax base is net capital gains. This source of income has steadily grown in amount and as a percentage of total gross New York income since the mid-1990s. For example, in 1995 net capital gains totaled $14 billion and made up 4.1 percent of total gross income in New York. By 2010, net capital gains income increased to $45 billion and comprised 6.4 percent of total income. Over this period, net capital gains reached a high of $116 billion, or 15 percent of gross income, in tax year 2007. This was the strongest year over this period, as total gross income reached $778 billion just prior to the economic downturn that began in 2008.

Figure 10 displays the level of New York gross income over the 1995-2010 tax year period and the portion of this income comprised of capital gains and other sources of income. As the chart indicates, total income tends to grow in years when net capital gains increase and tends to diminish in years when gains decrease. The size of net capital gains can vary significantly from year to year. For example, net capital gains income was $81 billion in 2006, $116 billion in 2007, and $53 billion in 2008. Gains decreased further to $30 billion in 2009. Since most net capital gains income is taxed at higher marginal rates, these swings create a significant amount of volatility in the revenue stream and cause a substantial degree of uncertainty in the State revenue forecast.



Another way to measure the volatility of the income tax is to examine the distribution of taxpayers across income groups. The more evenly spread the tax is among income groups, the more stable the tax as a revenue source. The more concentrated the distribution of tax liability within certain income groups, the more volatile the revenue as income rises and falls within those groups.

Table 12 presents the percentage of income tax liability borne by income decile for tax year 1995 versus 2010.

Table 12: Percent of Income Tax Liability of Resident Taxpayers

	Tax Year	
Decile	*1995*	*2010*
First	0.4%	0.2%
Second	1.0%	0.6%
Third	1.7%	1.3%
Fourth	2.8%	2.0%
Fifth	4.2%	2.8%
Sixth	5.7%	3.8%
Seventh	7.6%	5.3%
Eighth	10.3%	7.3%
Ninth	14.7%	11.3%
Tenth	51.6%	65.3%

Table 12 illustrates how taxpayers in the tenth decile (top ten percent of income) saw their share of total New York income tax increase from 51.6 percent in 1995 to 65.3 percent in 2010. While some of this was caused by temporary increases in top tax rates, the overall trend is that the income tax has become more dependent on higher income individuals. These higher income taxpayers are also the ones more likely to have bonus income and capital gains, the two most volatile sources of income.

- ***Sufficiency and Stability of the New York Income Tax***

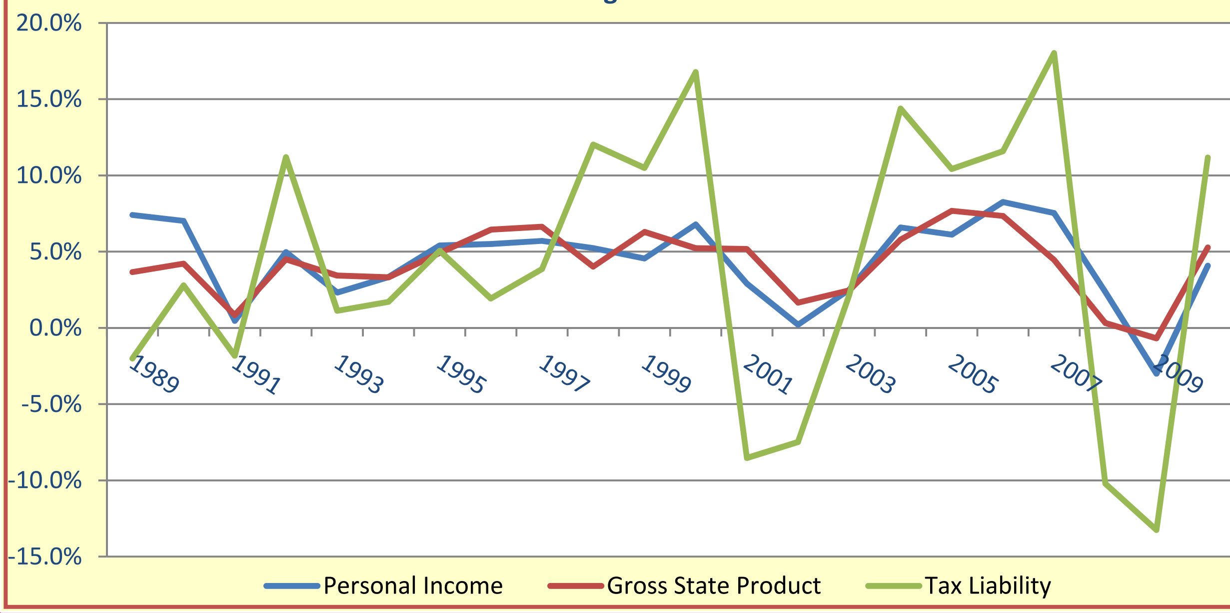
Two measures commonly used in the public finance literature to determine how well a tax performs are revenue sufficiency (long term adequacy) and revenue stability (short term adequacy). The concept of revenue sufficiency for the income tax involves understanding how well the tax base responds to changes in the State's economy. Revenue stability is a similar (and equally important) concept that relates to understanding the impact of the business cycle on the ability of the income tax to generate adequate revenue in the short term.

There are a number of measures that can be used to gauge the performance of the economy at the state level. Personal income is often considered to be a valid statistic for measuring the relative strength or weakness of the economy over time because it measures income, which rises and falls with the fluctuations of the economy. However, personal income, as defined by the U.S. Bureau of Economic Analysis, differs from federal adjusted gross income, the starting point for the determination of the New York income tax base. For instance, FAGI includes capital gains/losses and pension and annuity benefits, but personal income as defined does not include these items.

Another measure that is typically reported and used for measuring the performance off the economy is gross state product, or GSP, which measures the economic output of a state over a given time period. These measures are generally reported in both constant and current dollars.

Figure 11 compares trends in New York State income tax liability by tax year with New York personal income and gross state product over the period 1989-2010. Data are reported in current dollars.

Figure 11: New York State Personal Income,Gross State Product, and Adjusted Personal Income Tax Liability Percent Change 1989-2010



The income tax liability series shown above has been adjusted for increases in revenue from the temporary income tax increases that were in effect in New York during tax years 2003 to 2005 and 2009 to 2010.

Figure 11 illustrates how income tax revenues in New York change more dramatically relative to changes in personal income and gross state product. This was especially true during the recessionary periods of 2001-02 and 2008-09, when change in liability was strongly negative in response to more moderate dips in income and GSP.

Changes in personal income, both positive and negative, generally result in larger changes in tax liability. Tax liability is therefore considered to be "positively elastic" with respect to income. This is largely attributable to the marginal tax rate structure of the New York income tax. Increases in taxable income move people on the margin into higher marginal tax brackets, resulting in a higher rate of increase in liability for a given rate of increase in income. Conversely, decreases in taxable income move people on the margin into lower marginal tax brackets resulting in a lower rate of change in liability for a given rate of change in income.

F. *Economic Development*

The effect of taxes on location decisions is the subject of considerable research. While the results have been largely inconclusive, states continue to market the image of having a positive tax climate. A "good" tax structure should promote a state tax system as being competitive with tax systems in other states.

New York is widely regarded as being a high tax state. This portrayal is illustrated by interstate tax comparisons, in which New York ranks 13th in total state taxes per $1,000 of personal income and 2nd in total state and local taxes per $1,000 of personal income behind only Alaska, which exports much of its tax burden through oil severance taxes. .The New York City income tax contributes to the local burden as well. In terms of top tax rate, New York's top rate of 8.82 percent ranks 7th among the 41 states with a broad-based income tax. The combined state and local top rate in New York City equals 12.696 percent, the highest in the country.

However, not all facets of New York's income tax structure rank poorly in comparison to other states. One of the features that create a high degree of progressivity in the State's income tax is the robust level of its tax-free threshold. This figure represents the level of income before a taxpayer encounters a positive tax liability. In 2011, New York's tax-free threshold for a two-parent family of four was $40,700, or $17,682 above the U.S. poverty level for the same family characteristics. New York has the second highest tax-free threshold, behind only California, among the 41 states with a broad-based income tax. New York's large standard deduction and numerous refundable credits, including the earned income tax credit and Empire State child credit, contribute to this high tax-free threshold.

New York also has one of the most favorable income tax climates for senior citizens living on retirement income. New York is one of 27 states that fully exempt Social Security income from state taxation. 17 states, including New York, exempt military pensions, and New York is one of just 10 states that exempt all government pensions (federal, state, and local). There are only 5 states that fully exempt all private pensions. New York is not one of those states, but it does exclude the first $20,000 of private pension income from taxation.

Taxpayers who operate businesses pay under the State's income tax if they are sole proprietors, partners in a partnership, members in an LLC, shareholders in an S corporation. Sources of business income are then co-mingled with other forms of income from other jobs, spousal income, and income from savings and investments to determine overall tax liability. Issues have been raised that New York's high tax rates discourage business formation and retention. In tax year 2010, 2.3 million resident taxpayers, or about one-quarter of the resident taxpaying population, had some form of business income on their return. Of those taxpayers with business-type income, less than 15,000, or 0.6 percent, would be in the current top rate bracket of 8.82 percent. The remaining 99.4 percent would face tax rates of 6.85 percent or less.

In order to support small businesses, the newly enacted State budget created a subtraction modification for residents with small business or farm income. A small business is defined as a sole proprietor or farmer employing one or more persons during the year and has net business or farm income less than $250,000. The modification equals 3 percent of the net items of income for tax year 2014. The rate increases to 3.75 percent in 2015 and to 5 percent in 2016 and years after.

AN EVALUATION OF NEW YORK STATE'S ADMINISTRATION OF PROPERTY TAX ASSESSMENT IN NEW YORK STATE: CURRENT STATUS AND OPPORTUNITIES FOR IMPROVEMENT

Prepared for the New York State Tax Reform and Fairness Commission

May 2013

I. Introduction

New York's system of administering the assessment of real property differs markedly from those typically found in most other states. The major differences are:

a. New York has not established a single valuation standard, or set of standards, that applies to all properties
b. New York does not require that assessments be updated periodically
c. With over 1,100 assessing units, New York has many more than most states of comparable size, and in some instances two different assessing units establish different values for a single parcel of property

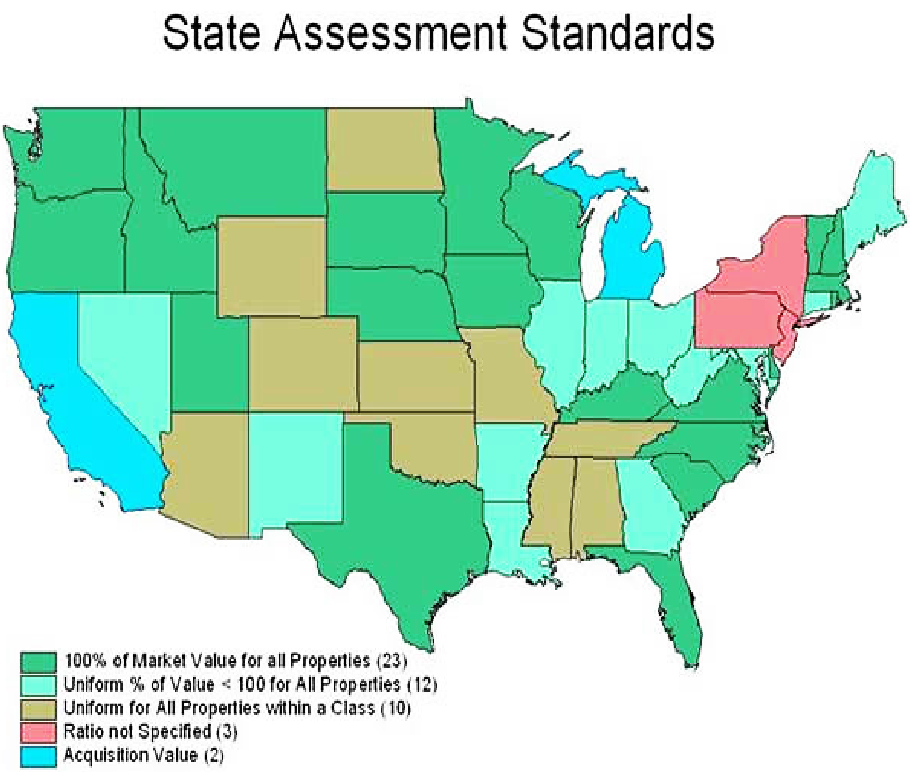
These factors have a statutory basis in New York, and that statutory framework in question has been particularly resistant to reform. As a result, virtually all the improvements to property tax administration that have occurred over the past several decades have been brought about by factors other than statutory changes.

Valuation Standards

Since the property tax is an *ad valorem* tax, the most important step necessary to its administration is establishing the value of each property. This function, generally referred to as *assessment*, is carried out by a government official known as an *assessor*. Since the tax is levied annually, usually by multiple taxing entities such as counties, cities/towns, school districts, villages, and independent special districts, assessments must also be available annually. In order for the tax to be levied equitably, assessments should reflect the current condition and value of properties. Ideally, the governing statute(s) should clearly define the "value" that is to be determined, to guide assessors in their work.

As shown in Figure 1, data collected by the International Association of Assessing Officers (IAAO) indicate that a majority of the states assess all properties at market value, or a specified percentage thereof, with a minority assessing different property types at different, but fixed, percentages of market value (e.g., 70 percent in Connecticut). Three states now assess property at "acquisition value," meaning its value at the time the current owner acquired it, an approach pioneered by California under Proposition 13 in the late 1970s. Only three states – New York, Pennsylvania, and New Jersey – allow for assessment at percentages of market value that may vary throughout the states in question.

Figure 1



Source: International Association of Assessing Officers

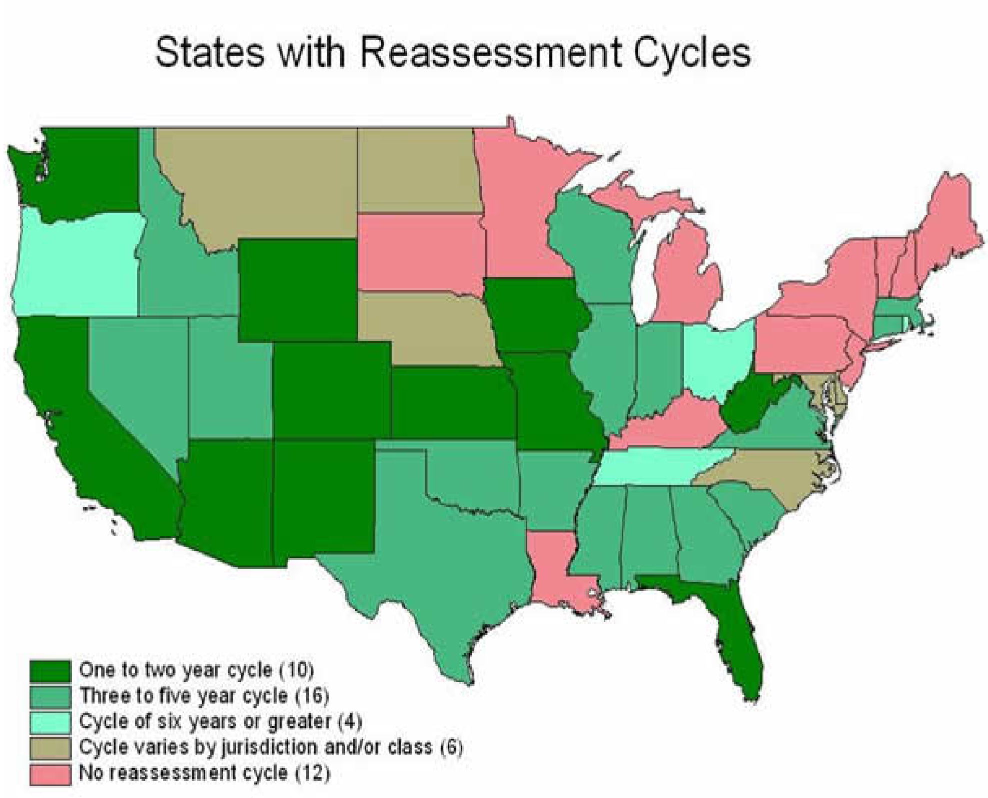
Until 1981, New York law required assessment at market value, but at that time, many communities were not keeping assessments up to date, in some cases for many decades, with the result that litigation of these practices had ensued. Chapter 1057 of the Laws of 1981, enacted over a gubernatorial veto, amended Section 305 of the Real Property Tax Law to repeal the full market value standard and allow instead the use of a "uniform," but unspecified, percentage of market value by each assessing unit. In addition, the State's two largest assessing units – New York City and Nassau County -- were allowed to assess four classes of property (residential, apartment, utility equipment, and all other property) at differing percentages of market value, but prevented from raising assessments by more than a certain percentage annually for classes other than the utility equipment class. Finally, other localities that had reassessed were allowed to establish differential tax rates for the residential and non-residential property classes. These actions essentially sought to legalize the status quo, and removed litigation-related pressures on the State's assessing units to update their assessments to current market conditions. The implication of this situation is that two properties that are located in the same community and have the same market value may have radically different assessments, and thus bear very unequal tax burdens, fundamentally undermining the equity of the system.

In the absence of a workable definition of "value" to be used for assessing, New York courts have found it necessary to intervene, with judicial clarifications of the ambiguous statutory language. In 1985, the Court of Appeals held that the term "value" means "market value" (*Foss v. City of Rochester*, 65 N.Y.2d 247, 480 N.E.2d 717, 491 N.Y.S.2d 128 (1985)). In further litigation establishing that the current use of a property, rather than a potentially more profitable use, was the relevant consideration in determining market value for assessment purposes, the Court of Appeals confirmed that "[t]he relevant consideration in assessment cases is the property's value on the taxable status date - not its future use or value or the intentions of the owner" (80 N.Y.2d at 360, 590 N.Y.S.2d at 422).

Assessment Updating Standards

As shown in Figure 2, a majority of the states require reassessment on a cycle of five years or less. Typically, values are not redone annually, in order to strike a balance between keeping up with market changes and the cost of doing so. A few states use update cycles of six years or more, and a few vary updating frequency by type of property. Only eleven, including New York, do not impose an assessment update cycle.

Figure 2



Source: International Association of Assessing Officers

Outdated assessments result in tax inequities because, as time passes, the relative values of properties change, so two parcels that may have been of equal value several decades ago may have very different values today. An additional problem is that property owners have difficulty understanding whether or not they are bearing a fair share of the tax burden since, despite court-ordered interpretations of the key statutory terminology, they must interpret a numerical value for their property that may bear little relation to the current market (e.g., a value of $1,000 listed as the assessment of a home that is worth $200,000). Contesting such an assessment may well require an independent appraisal, and an estimation of what the assessment should be if it were set at the same average level prevailing in the assessing jurisdiction. Furthermore, states such as New York that use the market value of property as a factor in programs, such as distribution of state aid to localities, must undertake expensive programs of market data analysis that effectively convert the total values of local assessment rolls to a current market value basis.

Assessment of Complex Properties

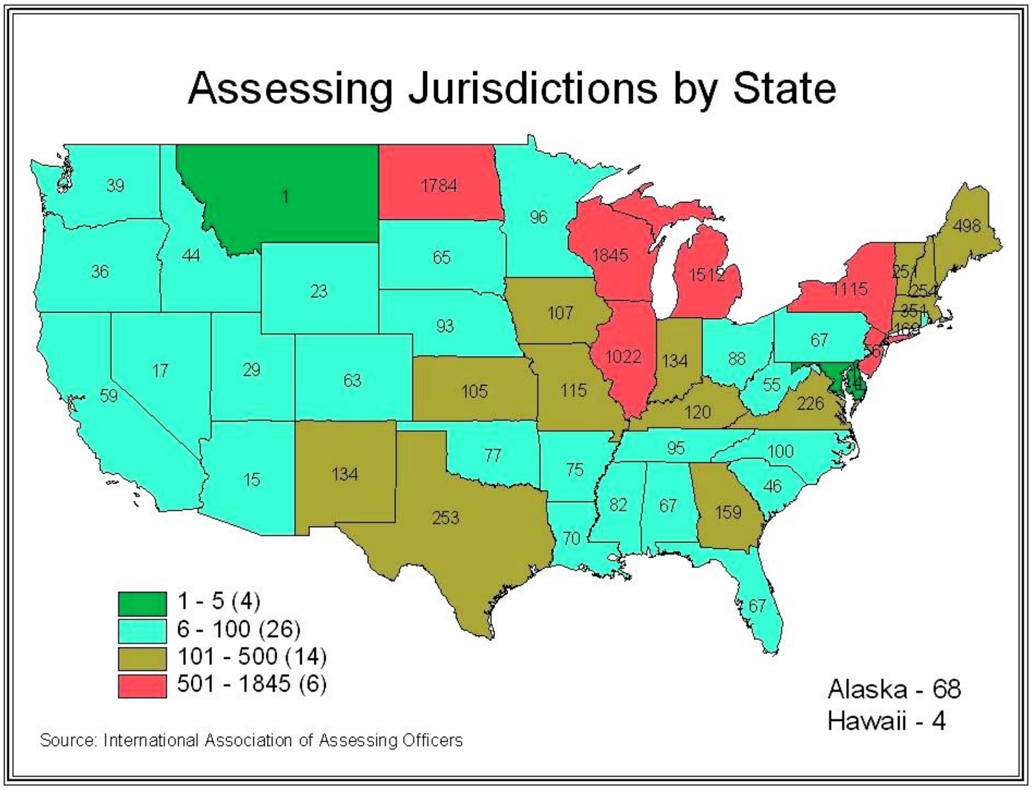
In recognition of the fact that some properties may cross the boundaries of assessment jurisdictions (such as railroads, water supply systems, utility lines, etc.) or are otherwise large and complex due to highly specialized industrial or commercial uses, many states assume responsibility for their assessment. A total of 27 assess all utility property, and at least six also assess complex industrial and commercial units. This centralization of complex assessment activities removes a substantial burden from local government assessing jurisdictions, and results in greater efficiencies, since the specialized engineering, accounting, and appraisal skills that are required for such properties need not be present in each local assessing unit.

In New York, recognition of the complex property issue is found in the State's arrangement for State assessment of "special franchise" property, which is utility property located on, over, or under public lands. It may also be observed in the State's arrangements for assessing railroad property under the aegis of State-determined "railroad ceiling values," which establish a maximum taxable assessment for railroad property. In a similar vein, the State supplies "advisory appraisals" for specified complex property to local assessing units in years when they are reassessing. However, these arrangements together comprise a complicated patchwork system that omits much complex property (e.g., utility equipment located on private land) and may result in preparation of costly State advisory appraisals that are not binding and may not actually be used by some of the assessing units that requested them. Furthermore, in those assessing units choosing not to reassess, complex properties may well be assessed inequitably or otherwise incorrectly.

Number of Assessing Jurisdictions

Nearly all of the states have 500 or less assessing jurisdictions (Figure 3), and most have less than 100. Only a few, predominantly located in the Great Lakes area, approach the more than 1,000 found in New York, and in two – Maryland and Montana – the assessing function is performed by the state government itself. A unique feature of assessment organization in New York is that some villages (115 at present) assess all properties within their borders even though these properties are also assessed by the respective towns in question, and two cities in Nassau County assess all properties within their borders even though the County also assesses them. This extremely localized and sometimes duplicative performance of the assessment function has implications for administration costs, as discussed below. On the other hand, two New York counties – Nassau and Tompkins – perform the assessing function for all parcels within their boundaries, although in Nassau, its two cities and many of its villages also assess, thus duplicating the County's efforts.

Figure 3



II. Measuring Progress in New York's Assessment Administration

As discussed above, New York compares unfavorably to most other states in the important features of assessment administration. The lack of clear statutory requirements for valuation, the failure to require periodic updating of values, and the inefficiency resulting from a very large number of small assessing units, have together served as impediments to the achievement of equity and efficient administration of the property tax.

However, despite the absence of appropriate State requirements that would help ensure such outcomes, much progress has nevertheless been made, in large part through local government initiatives that have been aided by technical and financial aid programs provided by New York State. The following sections outline data that chart the changes in key assessment-related attributes over time.

Assessment Equity

Assessments are used to distribute the total property tax levy for a local jurisdiction that is determined independently by each local government based on its analysis of projected expenditures and any revenues from other sources for its upcoming fiscal year. In order to ensure fair distribution of such levies, assessments must accurately reflect relative property values (i.e., similarly valued properties should have similar assessments).

A widely used measure of assessment equity/uniformity is a statistic known as the coefficient of dispersion (COD). The COD measures the relative variation or "error" in assessment ratios (assessed value divided by market value), expressed as a percentage of the median ratio. Ideally, it should be zero, but the inexact nature of value determination always requires some level of allowable tolerance. Experience has demonstrated that lower COD levels can be achieved in communities with plenty of sales, and for certain more homogeneous property types, such as residential parcels. In recognition of these factors and based on recommendations of the IAAO, the State has established guidelines for assessment uniformity according to the population density of assessing units. These range from a COD of 15 (average "error" of 15 percent) for those heavily populated units of an urban and suburban character, 17 for intermediate density communities, and 20 for the most rural ones.

Figure 4 shows the status of assessment equity based on analysis of 2011 assessment rolls. The data indicate that approximately 74 percent of the State's county, city, and town assessing units are meeting the established guidelines for uniformity, even though they are not required to do so by State law or regulation. These results are also reflected in the data presented in Table 1, which show that 709 of the assessing units have reassessed during the past decade. However, with respect to the minority of jurisdictions with older assessments, many have not reassessed in decades, and a few have not completed general reassessments in nearly a century.

The available evidence suggests that State technical and financial assistance for reassessment programs have been important in achieving the current level of voluntary adherence to guidelines. However, it is also apparent that, for some assessing units, the availability of this aid is not a sufficient incentive, and State standards would be required to ensure that taxpayers in these communities pay equitable shares of local property taxes.

Figure 4

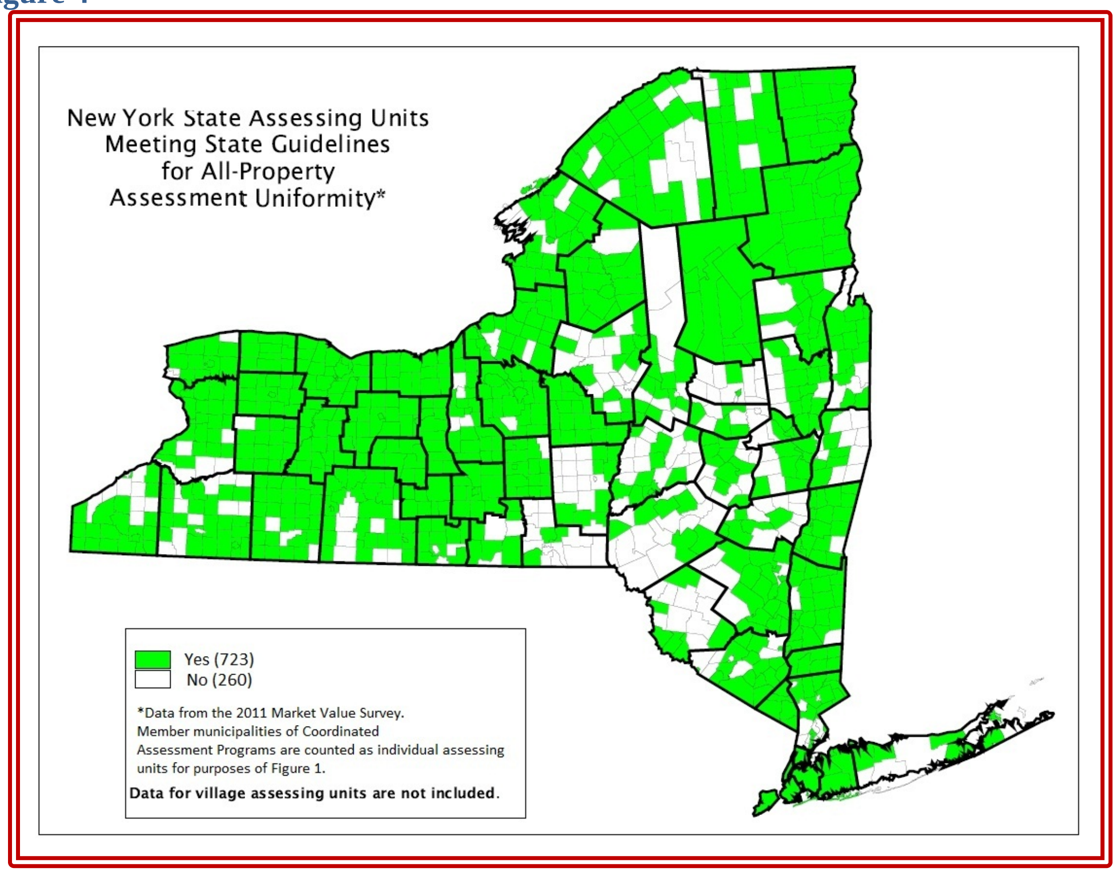


Table 1: Year of Most Current Reassessment: Non-Village Assessing Units

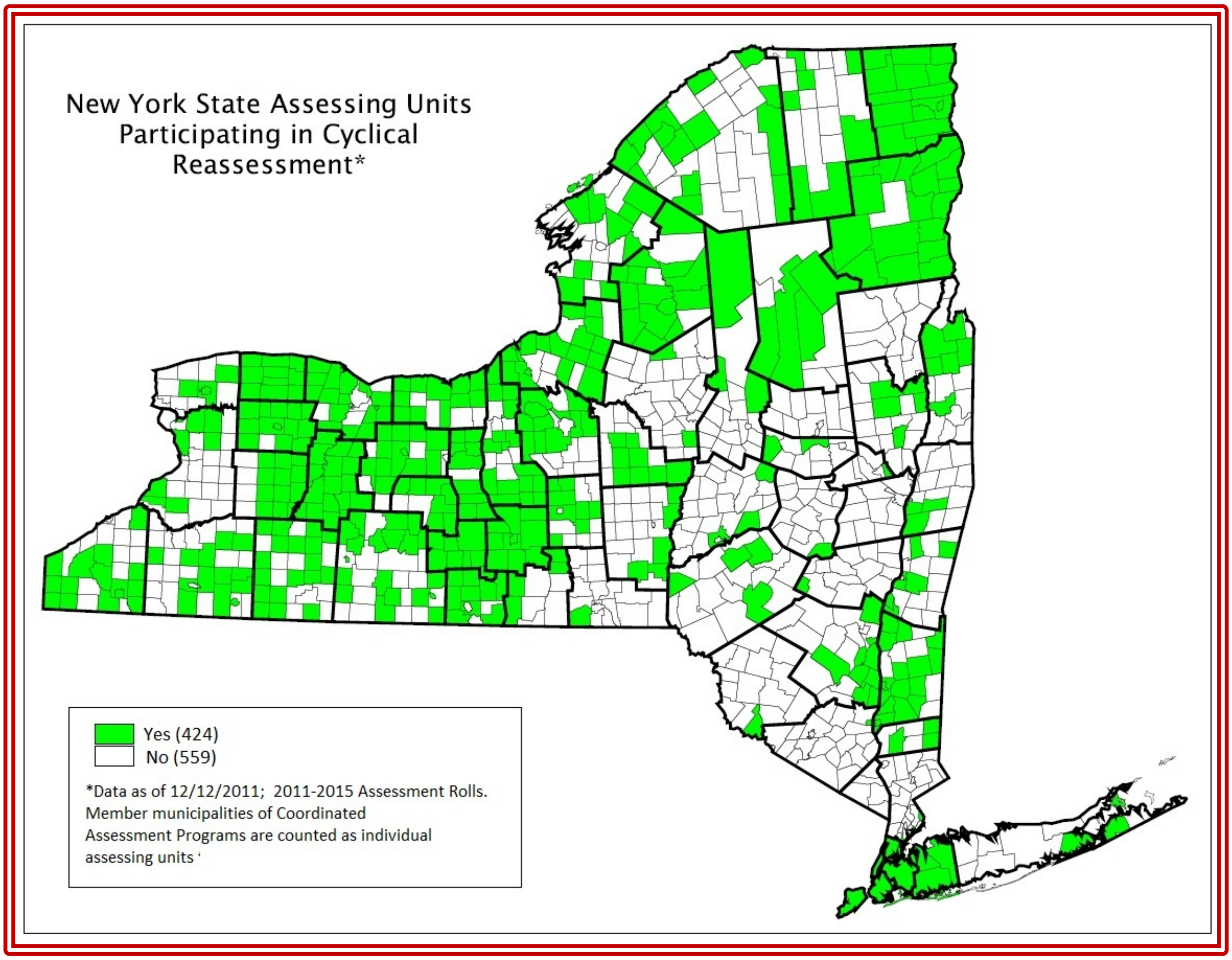
Year	Number of Assessing Units
2008-12	569
2003-07	140
1998-02	46
1993-97	41
1988-92	48
1983-87	18
1974-82	32
pre-1974	89
Total	983

Assessment Updating

Yet another indicator of the extent to which quality assessing practices are being adopted in New York is the level of voluntary participation in the State-sponsored program for cyclical updating of assessment rolls. The approximately 43 percent of jurisdictions that participate are shown in Figure 5. This program utilizes a standardized four-year update cycle, and participating assessing units enter into an agreement to fulfill the program's requirements in exchange for financial and technical assistance. Program participation involves a multi-year commitment to keeping assessment rolls current with market conditions and changes to properties and indicates that those participating are attempting to assure property owners that they will be treated equitably on an ongoing basis.

Taken together, the various data presented regarding the extent to which New York assessing units have accurate and current rolls present a picture in which nearly three-quarters are maintaining equity through voluntary compliance, while the remaining one-quarter are not maintaining equity because they are not updating their rolls frequently enough.

Figure 5



Scale of Assessment Administration

A breakdown of New York's assessing units by size category is given in Table 2, which omits the duplicative village assessing units for the sake of clarity. As is apparent from the data, about half of the assessing units contain less than 2,000-3,000 parcels, sometimes used as a guideline as to the number a single assessor can manage without assistance. Approximately half of the assessing units have less than 2,000 parcels – clearly below a full-time workload for an assessor.

Table 2: Number of New York Assessing Units by Size Category
(2011 assessment rolls)

Number Parcels	No. of Assessing Units (excl. villages)
<500	11
500 – 1,000	122
1,000 – 2,000	339
2,000 – 5,000	333
5,000 – 10,000	99
10,000 – 25,000	56
25,000 – 50,000	14
>50,000	9
Total	983

Promising Trends

Despite the persistence of this highly disaggregated style of delivering the essential government service required to levy the State's largest tax, substantial changes have occurred over time. One such change concerns the selection of assessors. Decades ago, nearly all New York assessors were elected, and consisted primarily of three-person boards. However, statutory changes in the 1970s that were directed at improving assessment practices allowed, among other reforms, the appointment rather than election of assessors.

This new direction reflected widespread opinion within government that assessing was a technical function, requiring specialized skills, and that a process of selecting assessors based on local popularity would not result in the selection of those with the needed skills. Furthermore, it could potentially influence incumbents' determinations of property value or other such critical decisions and duties. This reform dramatically changed the staffing of assessment in subsequent decades, with the result that 90 percent of assessing units now have appointed assessors, up from about half in the early 1980s (Table 3). And, as shown in Table 4, there is a strong association between appointment of assessors and attainment of assessment equity.

Table 3: The Changing Profile of New York Assessors (Percent of Units with Appointed vs. Elected)

Year	Appointed	Elected
1983	48%	52%
1986	54%	46%
1990	59%	41%
1994	67%	33%
2000	77%	23%
2005	83%	17%
2006	84%	16%
2007	86%	14%
2008	87%	13%
2009	88%	12%
2010	88%	12%
2011	90%	10%
2012	90%	10%

Table 4: Equity Attainment and Assessor Selection, 2012

	Appointed	Elected
Percentage with Equity*	76%	49%
Percentage without Equity*	24%	51%

* percentages calculated based on non-village assessing units, rather than assessors

During the same time period, there emerged a rapidly increasing need for computerized data analysis skills, and many smaller rural communities had difficulty in securing assessors with such qualifications at an affordable cost. In combination, these trends have resulted in multiple communities now employing the same assessor. More than half of all assessing units in New York currently employ an assessor who also serves in one or more additional assessing units (Table 5). A relative few of these assessment arrangements are set up under a formal statutory program (Section 579 of the Real Property Tax Law) that creates "Coordinated Assessing Units," but the great majority are informal. In either case, they represent a significant trend toward efficiency and professionalization in assessing.

Table 5: Multi-Jurisdictional Assessing in New York

Year	Total No. of Assessing Units*	No. with Multi-Jurisdictional Adm. Units	No. with Multi-Jurisdictional Adm. Assessors
1983	1,546	N/A	N/A
1987	1,435	144	59
1992	1,294	190	74
1997	1,177	361	133
2004	1,092	449	162
2008	1,044	501	173
2009	1,034	506	172
2010	1,029	526	181
2011	1,022	544	186
2012	1,020	553	192

* Includes village assessing units

Existing County Models of Improved Assessment Administration

A number of communities throughout the state have voluntarily taken steps that helped them improve the equity and efficiency of their assessment systems. Three examples are discussed below, selected from the many cases that might have been chosen.

Clinton County:

For several decades, Clinton County officials have sought to provide a high level of service to the County's municipalities, most of which are small rural communities, with a typical size of about 2,500 parcels and one having only about 800 parcels. The essentials of Clinton's approach are that the County provides assessment services to all but one of the towns, including parcel valuation services and the maintenance of an on-line system through which assessors can update parcel data. County staff may also assist assessors with basic data collection issues, and the County produces the local property tax bills. Larger municipalities, such as the City of Plattsburgh and Town of Plattsburgh, have the scale and resources to administer their assessing function on a more independent basis, so the County can concentrate its efforts on the smaller communities. The latest data (2012) indicate that all municipalities in the County have fully up to date assessments, and meet statewide standards for equity.

Livingston County:

With nearly 30,000 parcels, Livingston is one of New York's smaller, more rural counties, located in the west-central area of the State. Its seventeen towns all maintain assessments at current market value, and meet State-established equity guidelines. The County assumes a substantial role in assisting the town assessing units, undertaking major valuation responsibilities and performing tax billing functions. Every assessor in Livingston County is a multi-jurisdictional assessor, either for multiple municipalities in Livingston or for one or more in other nearby counties. In addition, a recent (May 2011) report by the NYS Comptroller entitled "Reducing the Cost of Tax Assessment Through Shared Services" found that assessing costs in Livingston County are below average, at $26.47 per parcel annually, as compared to the State average of $28.53.

Orleans County:

Located on Lake Ontario in Western New York, Orleans County has 10 town assessing units and no cities. At approximately 20,500 parcels, it ranks as one of the smaller counties in the State. The County itself has assumed an important role in terms of providing a single, online system which incorporates assessment data for all the towns. This system gives all the assessing units access to a larger pool of market data, enabling them to perform their work more effectively.

Of the 10 towns, five have assessors who also assess in another municipality. The County's assessments are all at current market value, and all municipalities meet State guidelines for equity. The previously referenced report by the NYS Comptroller found that assessing costs in Orleans County are among the lowest in the State, at $20.18 per parcel annually, or about 29 percent below the State average.

III. Opportunities for Further Improvements

The foregoing data indicate that significant progress has been made in assessment administration over a period of several decades, even after repeal of statutory requirements for market value assessing. This progress has been largely achieved based on the initiative of local governments that wish to provide for equitable allocation of property taxes among their taxpayers, and it has been facilitated by State technical and financial assistance programs designed to help them achieve this goal. However, not all local governments have participated, with over one-quarter still using very outdated assessment rolls to levy their taxes.

While many of the approximately one-quarter of all assessing units having extremely outdated and inequitable rolls are small rural towns scattered throughout New York, some of the populous downstate counties stand out as centers of exceptionally inequitable assessing. In Westchester County, for example, 13 of the 25 cities and towns did not meet minimum acceptable guidelines for assessment equity based on the 2012 market value survey carried out by the Office of Real Property Tax Services. These include the most populous communities in the County, including five of its six cities, which have not reassessed in many decades. Similarly, in Suffolk County, five of the 10 town assessing units did not meet the applicable guidelines. Together, these typically large and populous towns contain nearly 400,000 properties, representing two-thirds of the properties in the County.

It is perhaps no surprise that assessment inequities, especially when they are very prevalent in heavily populated areas with relatively high property taxes and real estate values, would generate a lot of assessment appeals. As indicated in Table 6, dramatic increases in appeals have been reported by the State Office of Court Administration, which oversees the program known as "Small Claims Assessment Review" that is typically used by those seeking court intervention regarding assessments of owner-occupied residential properties.

Table 6: Trends in Small Claims Assessment Review Cases, Suffolk and Westchester Counties

	----------Cases filed, by Calendar Year---------		
County	**2000**	**2007**	**2011**
Suffolk	4,057	12,851	33,877
Westchester	1,627	1,722	10,698

Source: NYS Office of Court Administration

In addition to the costs that taxpayers with inequitable assessments must pay in terms of unfair tax burdens and expenses related to assessment appeals, continuing inefficiencies in the way assessment is administered in New York also result in excessive costs to all taxpayers in the communities in question. However, unlike an inequitable assessment on a particular property, which can be addressed through the appeals process, individual taxpayers have no such direct recourse in situations involving an overly costly system of assessment administration. Although improvements have indeed occurred over the past several decades, New York's system of assessing is still in need of much improvement, as evidenced by the previously referenced study by the State Comptroller.

Local governments must report their financial data annually to the Comptroller, who may also audit their accounts and programs. For this report, costs associated with assessing property are separately identified in the reporting system, and were analyzed by the Comptroller in an attempt to discover if local government resources were being deployed efficiently. The results, as shown in Table 7, indicate that, despite past improvements in assessment organization and practices in most New York communities, savings amounting to millions of dollars could be realized through a more efficient system.

Table 7: Estimated Savings from Shared Assessing
(Statewide Estimates, excl. NYC and Villages)

More Conservative Est.		**Less Conservative Est.**
Reform	**Amount**	**Amount**
Share Assessors	$2.7 million	$6.1 million
Reduce Appeals	$5.1 million	$7.6 million
Update Assessments	($4.3 million)*	($4.3 million)*
Eliminate Duplication	$3.1 million	$3.1 million
Net Savings	**$6.6 million**	**$12.5 million**

The cost figure shown represents the statistical difference in costs for municipalities that have reassessed since 2005 as applied to those who have not. It does not represent the cost of reassessing property.

Source: NYS Comptroller, May 2011

The Comptroller's Office also made a number of specific recommendations that were all oriented toward achieving this potential savings. One recommendation was for increased use of shared assessing, as currently practiced by about half of New York assessing units. Another was for reassessment, with subsequent frequent updating, in instances where communities do not have up-to-date assessment rolls. This was identified as an effective means of avoiding growing assessment appeals burdens which, as pointed out earlier in this report, are now especially prevalent in downstate metropolitan areas that have not reassessed in a long time. Finally, the Comptroller recommended cessation of assessing by the relatively small minority of villages that still practice it, since it duplicates town or county functions for the same properties.

In addition to these recommendations by the Comptroller, one more that seems warranted is State assumption of responsibility for assessment of complex properties. As previously described, the present system consists of State assessment for utility property located on public land, with local assessors responsible for that situated on private land. In addition, State advisory appraisals are provided for large industrial/commercial/utility units that are being reassessed but these State appraisals are not binding on the assessing units, and may thus represent wasteful usage of State resources. Thus, State assumption of assessment responsibility for all complex properties would be a substantial improvement.

Summary of Necessary Improvements

- ✓ Establish a clear, statutory standard of assessment, preferably 100 percent of current market value
- ✓ Require that assessments be updated on a regular basis
- ✓ Structure State programs of technical and financial assistance to assessing units in a manner that will provide strong incentives for greater consolidation of the assessing function
- ✓ Require State assessment of all complex properties