# Testimony before the
# Finance Committee of the New York City Council

## *Impact of the Federal Tax Law on New York City*
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Good afternoon, Mr. Chairman, and members of the Finance Committee. My name is James Parrott, Director of Economic and Fiscal Policies at the Center for New York City Affairs at The New School. Thank you for the opportunity to testify on the impact of the recently-enacted federal tax law on New York City.

1. **Giant set-back for tax fairness**

Make no mistake, the Tax Cut and Jobs Act ("tax bill") that was rushed through Congress in the waning days of 2017 was not "tax reform," it was intended to be an unprecedented tax cut geared to benefit the largest corporations and super-rich political donors.

While the tax bill provides some degree of tax cut for many New Yorkers, in looking at the combined effects of all its aspects, it is clear that it provides the overwhelming bulk of tax reduction to the wealthiest 5 percent. Mainly as a result of the limit on the deductibility of state and local taxes, approximately one in eight New Yorkers will pay more federal tax in 2019, with the incidence of that concentrated in the upper middle income range.

Taxpayers in the top five percent have average incomes of nearly $1 million; on net, their average tax cut will be about $16,900, 43 times the average $390 reduction going to those in the bottom 60 percent of the income distribution who have average incomes of $33,300. See attached Figure 1.

The rich garner most of the benefits of the steep reduction in corporate taxes since they own a very high portion of all corporate stock. The new 20 percent deduction allowed for pass-through business income was falsely advertised as mainly benefiting small businesses when the reality is that 85 percent of the associated tax reduction will flow to the richest 5 percent in New York.[1]

This extremely top-heavy tax cut comes in the context of the pronounced income polarization of recent years, and against a back-drop of a regressive overall New York State and local tax structure (see attached Figure 2), and a highly regressive New York City local tax structure (see Figure 3.)

## 2. Economic impact

There is no clearcut answer to the question, "What is the overall economic impact of the Tax Cut and Jobs Act?" It certainly will increase the federal deficit by over a trillion dollars in its first decade. Normally, that would lift the economic growth rate. And it may in this case, but there are some off-setting factors that have to be kept in mind. Consider three factors: how the Federal Reserve will respond, the extent to which the deficit increase is offset by federal spending cuts, and the fact that the large corporations mainly benefitting from the corporate tax cuts have shown little inclination to boost domestic investments in recent years despite already very-high after-tax profit levels.

A dramatic increase in deficit spending may be warranted when there is a lot of slack in the economy, but the national economic recovery is now in its ninth year, unemployment is fairly low, and the Federal Reserve has already begun to raise interest rates. Recent stock market gyrations were largely due to concern about the effect a much higher federal deficit might have in leading the Federal Reserve to raise interest rates faster than previously anticipated. The cumulative effect of several interest rate increases by the Federal Reserve will be to slow the pace of economic growth, and many times in the past such steps have resulted in a recession. In addition, the President's recently released budget proposes sharp cuts in many domestic spending areas that would further fray the safety net and retard economic growth and long-needed public investments in infrastructure.

[1] The tax bill also included repeal of the individual health insurance mandate penalty under the Affordable Care Act, widely considered to result in higher premiums in the individual market and fewer people with health insurance. Timothy Jost, *The Tax Bill and the Individual Mandate: What Happened, and What Does It Mean?* Health Affairs blog, December 20, 2017.

It should be noted that even without additional federal economic stimulus the New York City economy has, in recent years, been experiencing its strongest sustained job growth, low unemployment, and fairly broad-based wage and incomes gains in decades.

### 3. New York's competitiveness and fiscal federalism

There is no question that, in acting to tightly limit the deductibility of state and local income and property taxes, the authors of the federal tax bill sought to harm states like New York and California that have long and deeply-rooted traditions of caring for the poor, providing expansive public services and better health care access. Limiting state and local deductibility goes against the century-old tenet of ***fiscal federalism*** that dates to the early days of the federal income tax. Most public services and infrastructure investments are provided in this country by state and local governments—this tax bill comes down squarely on the side of a heavy-handed federal government discouraging states and localities from serving the needs of its citizens and making needed investments in our economic infrastructure. Governor Cuomo's office estimates that the new federal limits on the deductibility of state and local taxes will cost middle and upper income New Yorkers who itemize deductions an estimated $14 billion.[2]

We should be concerned about the possible effect of the limit on state and local deductibility on the State and the City if it leads high-income households to pull up stakes for lower-tax jurisdictions. However, we should keep in mind that the combined City and State tax burden has been higher than in many areas for several years, and still the net number of high income households in New York City has risen steadily in recent years. The best available research on the question of millionaire migration and taxation finds that the rich are generally so tied to local economic and social networks that they have largely not moved out of states that have imposed higher income taxes. [3]

### 4. Impact on New York City taxes

Assuming the state legislature enacts measures proposed by the Governor to decouple the New York State tax code from the federal tax code, the federal tax bill may not have much of a direct impact on New York City tax collections (assuming there aren't significant macroeconomic effects.) The Governor has proposed to retain (without limit) the state

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[2] New York State Division of the Budget, Summary of Proposed Tax Reforms, FY 2019 Executive Budget 30-day Amendments, February 2018, p. 1.
[3] Cristobal Young, Charles Varner, Ithai Z. Lurie, and Richard Prisinzano, *Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data*, American Sociological Review, 2016, pp. 421-446.

deductibility of local property taxes, to eliminate the requirement that taxpayers may only itemize deductions on their New York return if they itemize on their federal return, to decouple from the federal tax bill's increase in the medical expense deduction and decreases in other itemized deductions, and a change to allow single-filers to claim the standard deduction in the wake of the elimination of the personal exemption on federal returns.[4] Since New York City uses the New York State tax form for itemizing deductions, the proposed changes regarding itemized deductions to the state income tax will apply to the city income tax as well.

Generally, the City and the State will have to monitor how the new federal tax bill is implemented and interpreted, and make further adjustments as needed to prevent harm to the City's and the State's tax base. One area where this is a particular concern is how the reduced federal corporate tax on the repatriation of corporate profits held overseas is implemented.

### 5. Potential impact on federal aid received by the City budget and city residents

New York City and New York State budgets are heavily dependent on Federal aid, particularly in areas like health care, education, housing and human services. Well over one-third of the state budget is federal aid, and while only 10 percent of the City budget comes from federal aid, both the NYCHA and Health + Hospitals budgets receive half or more of their funding from the federal government, and the City budget backs up both of these budgets. To take just one example, 43 percent of the budget of the Administration for Children's Services comes from federal aid.

There is a real risk that the increase to the federal deficit resulting from the federal tax bill could be used to justify steep cuts in many areas of federal aid critical to the City budget and the people of New York City. To take just two of many examples, rental housing assistance and food stamps are both targeted for sharp cuts in the President's recently released federal budget proposal. The President's new budget calls for a 42 percent inflation-adjusted cut in non-defense discretionary spending over the next decade that would take it to its lowest level as a percent of gross domestic product since Herbert Hoover was President.

To the extent there are harmful federal budget cuts affecting New Yorkers, the state and the city should consider a targeted federal tax cut windfall recapture tax to provide additional state and city revenues to offset some of the federal cuts.

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[4] New York State Division of the Budget, Summary of Proposed Tax Reforms, FY 2019 Executive Budget 30-day Amendments, February 2018, p. 4-5.

## 6. Tax workarounds might be unworkable

In his 30-day amendments, Governor Cuomo has proposed two workarounds to offset some of the higher federal taxes that New Yorkers would pay under the Federal tax bill. One of these is an "employer compensation expense tax" that would function like a state payroll tax that would go to the state on behalf of an employee with wages over $40,000 a year and lessen by a like amount the state income tax owed by that employee. Such a tax would lessen the employee's federal tax liability. Employers would have the choice to opt in. While I am sympathetic to the motivation behind such a mechanism, I think such a tax would be difficult to implement fairly and efficiently, and would be disruptive of normal compensation practices and collective bargaining agreements. If it chose to do so, the City could opt to create a similar mechanism for city taxpayers.

Another of the Governor's proposals is to set up two new funds benefiting state education and health care services that would receive charitable contributions from New York taxpayers, and for which contributing taxpayers would receive a federal tax deduction, provided they itemize deductions. The taxpayer would be able to claim those contributions as deductions on their federal and state returns and would receive an 85 percent state income tax credit for such charitable contributions. The Governor's proposed legislation also authorizes school districts and local government units to create charitable funds for education, health care, and other charitable purposes, and allows taxpayers to receive a reduction in local property tax bills equal to 95 percent of the donation.[5]

Both of these approaches are laudable in intent given the punitive nature of the federal tax bill, but I believe both are adminstratively complicated, subject to legal challenge, and might lessent support to repeal this disastrous federal tax bill. These measures would be geared to those upper middle and high income taxpayers who would owe more federal income tax due to the limit on the federal deductibility of state and local taxes. However, these groups have also already benefitted significantly from state income tax reductions enacted initially in the FYs 2012 and FY 2017 state budgets. Priority in any Albany tax changes should be given to measures to lessen the regressiveness of our state and local taxes.

[5] Ibid., p. 3.

## 7. The top NYC  tax reform priority is to fix the City’s residential property tax

Tax experts across the policy spectrum all agree that various inequities plaguing the City’s property tax system urgently cry out for reform. Four ingredients are necessary for true property tax reform. First is a blueprint to correct the problems in current State law. Second, reform should include a “circuit breaker” provision, administered through the local income tax, limiting property taxes in relation to family income. Third, tenants of rent-stabilized units need guarantees that savings will be passed on to them if property taxes decline on rental properties. Finally, unnecessary and hugely costly property tax breaks that have favored the biggest developers and corporate real estate owners (Exhibit A: Hudson Yards) should be curtailed.

The goal should be to reduce disparities in effective property tax rates among residential properties and to lessen the overall regressivity of the City’s local taxes directly affecting households. Changes should be phased in gradually—a transition period of 10 to 15 years might be necessary.

Property tax reform has long been considered the third rail of local policy making. There will be winners and losers, and any reform involves a multitude of tradeoffs. This politically challenging balancing act could only be accomplished by a broadly representative group of New York City leaders appointed by the Mayor and the City Council. And, for any group to to be willing to take on this challenge, there first needs to be an ironclad commitment from Albany to defer to New York City on local property tax reform and to not seek to impose a different set of priorities.

Thank you for the opportunity to testify today.

# # #

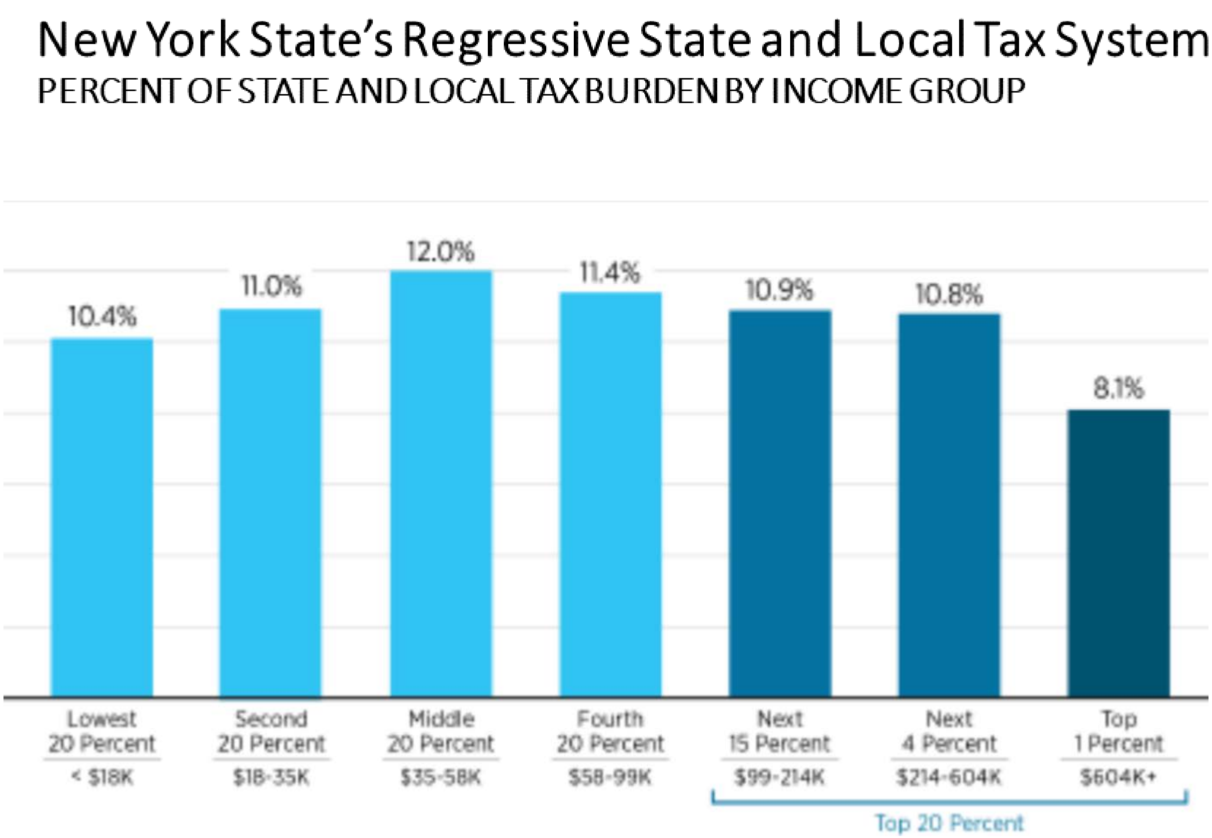
# Figure 1

**ITEP estimates of combined impact of Tax Cut and Jobs Act, New York State, 2019**

| New York State tax filers | income range | average income | avg. tax change | share of tax change | share with tax cut | share with tax hike | $ billions: individual income tax changes | pass-through businesses | corporate tax cuts | estate tax cut | TOTAL tax change |
|---|---|---|---|---|---|---|---|---|---|---|---|
| bottom 60% | < $67,910 | $33,300 | -$390 | 14% | 75% | 8% | -$1.677 | $0.000 | -$0.545 | $0.000 | -$2.280 |
| fourth 20% | $67,910-$120,560 | $91,200 | -$1,180 | 14% | 80% | 19% | -$1.551 | -$0.155 | -$0.589 | $0.000 | -$2.276 |
| next 15% | $120,560-$280,210 | $172,000 | -$2,150 | 20% | 72% | 27% | -$1.396 | -$0.635 | -$1.080 | $0.000 | -$3.110 |
| top 5% | > $280,210 | $991,621 | -$16,863 | 51% | 84% | 16% | $3.226 | -$4.953 | -$5.571 | $0.842 | -$8.139 |
| **ALL** | | **$112,300** | **-$1,620** | **100%** | **76%** | **13%** | **-$1.398** | **-$5.861** | **-$7.785** | **$0.842** | **-$15.805** |

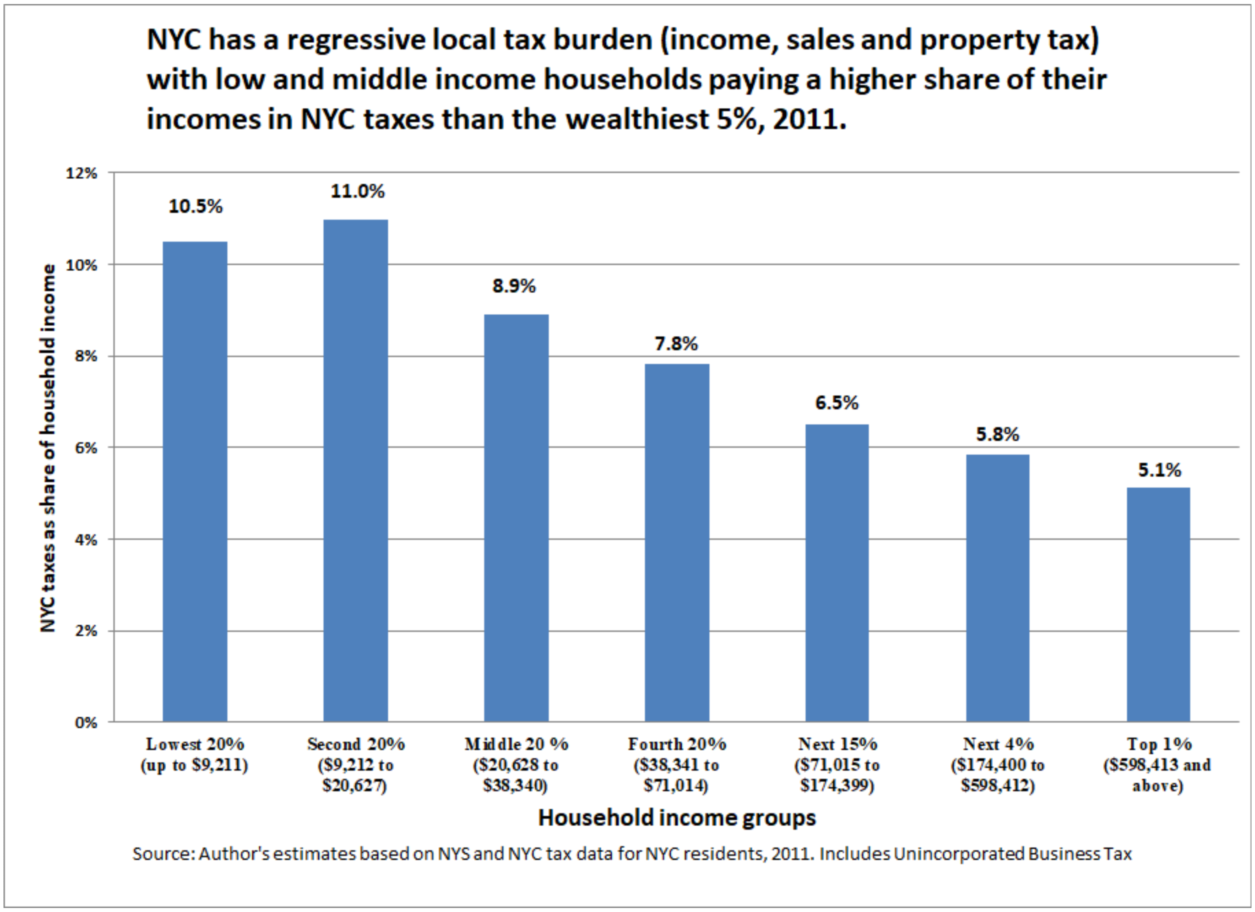
Source: Institute on Taxation and Economic Policy, The Final Trump-GOP Tax Bill: National & 50-State Analysis, Dec. 2017; and detailed NYS table at https://itep.org/finalgop-trumpbill-ny/

# Figure 2




Source: Institute on Taxation and Economic Policy, 2015.

# Figure 3


NYC has a regressive local tax burden (income, sales and property tax) with low and middle income households paying a higher share of their incomes in NYC taxes than the wealthiest 5%, 2011.
NYC taxes as share of household income
12%
10%
8%
6%
4%
2%
0%
10.5%
11.0%
8.9%
7.8%
6.5%
5.8%
5.1%
Lowest 20% (up to $9,211)
Second 20% ($9,212 to $20,627)
Middle 20 % ($20,628 to $38,340)
Fourth 20% ($38,341 to $71,014)
Next 15% ($71,015 to $174,399)
Next 4% ($174,400 to $598,412)
Top 1% ($598,413 and above)
Household income groups
Source: Author's estimates based on NYS and NYC tax data for NYC residents, 2011. Includes Unincorporated Business Tax