Partnership for New York City

CAN NEW YORK DEPEND ON A "MILLIONAIRE'S TAX" TO SOLVE THE BUDGET CRISIS?

February 2011

In 2009, New York State enacted a temporary personal income tax surcharge on "high earners" ($200,000+). This surcharge increased the top personal income tax rate by 31%. It was intended as an emergency measure to help the state through the economic recession of 2008–2010, when tax receipts plummeted. The surcharge was structured to sunset after three years, at the end of 2011, to mitigate the impact of this significant tax increase on affected taxpayers, who tend to be major contributors to job creation and employment in the state.

Today, the Downstate New York economy has substantially recovered and tax receipts are up, but New York State's underlying fiscal problems are worse than ever. As a result, interest groups that depend on state spending are pressing for permanent extension of the surcharge, which they dub a "millionaire's tax," even though 76% of the people who pay the surcharge are not millionaires.

The advocates of extending the surcharge to close this year's $10 billion deficit ignore the question of what Albany will do next year, or the year after, when deficits will continue to rise and the number of millionaires who work and live in New York State is likely to diminish. Making the temporary surcharge permanent would reduce a projected $65 billion state deficit over the next four years by only 25%. It does not solve the problem.

The argument for maintaining the surcharge on high earners is simple: better off New Yorkers can afford to pay more and the revenues they contribute will reduce pressure on Albany to cut education, health care and other important state programs. These arguments are undeniable, but they ignore important factors that suggest maintaining the tax surcharge is not in the best interests of economic growth, job creation, and the future of all the people of the state.

Extending the tax surcharge will not solve the budget crisis — but only prolong it.

New York's taxes are currently the highest in the nation and far higher than many places around the world that are competing for our jobs.

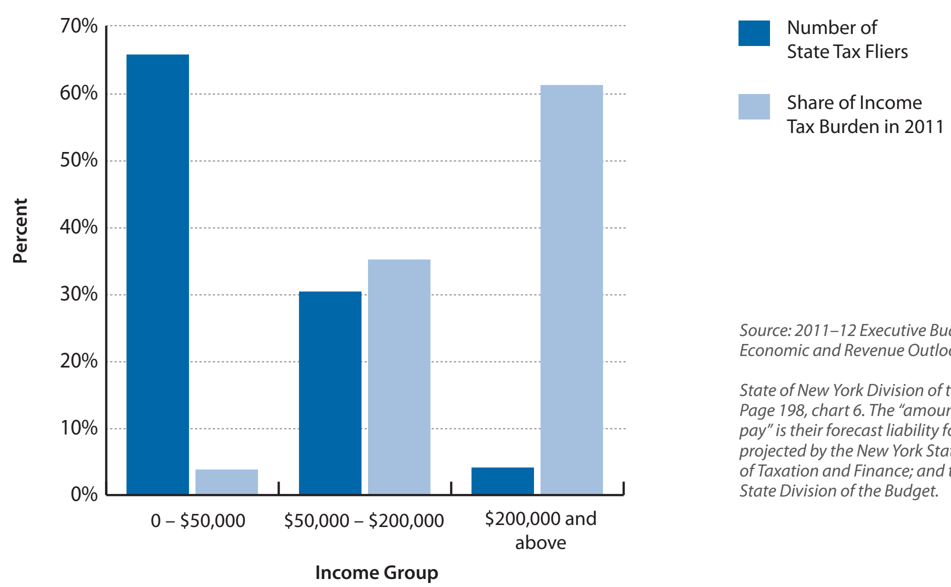
Overall, the state's tax climate is consistently ranked as among the nation's worst. In this post-recession period, employers are making major decisions about where to locate business operations and jobs. Entrepreneurs and investors are deciding where the emerging industry clusters of the future will have the most favorable environment for success. To these decision-makers, many of whom are hit by the tax surcharge, New York's high tax environment matters.

With the surcharge in place, New York State's top personal income tax rate is 8.97% — higher than all but seven other states. For New York City taxpayers, the top rate is 12.85%, the highest in the nation. Moreover, personal income taxes are only part of the tax burden in New York City. High earners tend to be the biggest consumers, paying a combined state and local sales tax rate of 8.875%, higher than any state's sales tax. There are six states that use sales taxes to fund their needs and do not impose any income tax. Electric bills in New York are 66% higher than the national average and the third highest in the country, largely due to state and local taxes that make up more than a quarter of the bill. Property taxes are also out of line with the country, with sixteen New York counties leading the nation in tax rates as a percentage of home value.

The size of the surcharge is not insignificant. In 2009, the 219,183 taxpayers subject to the surcharge paid an average of over $18,555 each on top of their normal income taxes, generating a total of about $4.1 billion in revenues. Most of these taxpayers (76%) earn between $200,000 and $1 million per year. The Alternative Minimum Tax (AMT), which generally applies to members of this income group, exacerbates the impact of the surcharge, since those taxpayers subject to the AMT lose the benefit of the deduction of the surcharge on their federal income taxes.

Small Business, the source of most new jobs and first jobs, is penalized by a high earner surcharge. In a recent survey by the National Federation of Independent Business, 71% of the small business owners polled in New York said they oppose the tax surcharge. Because of how small businesses are structured, 75% of small business owners report their entire business income through a personal income tax return. There are more than 1.6 million small businesses in New York, accounting for 99% of all businesses in the state and 57% of total employment. They generate some 42% of total gross receipts in the state. This is a time to support these businesses in their efforts to innovate and expand, not to extract more money from their bottom line.

Figure 1. Income Tax Filers in New York State and What They Pay (by Income Group)



Source: 2011–12 Executive Budget: Economic and Revenue Outlook.

State of New York Division of the Budget. Page 198, chart 6. The "amount they will pay" is their forecast liability for 2011 as projected by the New York State Department of Taxation and Finance; and the New York State Division of the Budget.

New York City and its immediate suburbs bear the brunt of the tax surcharge. The vast majority (81%) of high-earning households that may be subject to the surcharge live within the Downstate Metro New York Region (the five boroughs of New York City, Westchester, and Long Island). This downstate region already sends some $14 billion more in revenues to Albany than it receives back in aid and services, due to the deteriorated and dependent condition of the Upstate economy. The surcharge further skews the tax burden against the region that is the economic engine for the entire state.

New York's fiscal condition is dangerously reliant on a relatively small number of high-income taxpayers. Almost 60% of all New York State taxes are collected through the personal income tax. The recent recession demonstrated how sensitive this revenue source is to fluctuations in the economy.

With the surcharge in place, one percent of New York taxpayers pay 43% of all personal income tax revenues, up from 25% in 1994. At the other end of the income distribution, 35% of tax filers pay no income tax at all due to a combination of the Earned Income Tax Credit for families earning under $48,362 and other deductions. Trends over the past decade have dramatically increased the portion of revenues paid by a small number of high end taxpayers. While the public polls suggest that extending the tax surcharge on "millionaires" is popular, the question is whether the ever-growing dependence on high earners is sustainable or prudent. The following analysis suggests it is neither.

The distribution of the state income tax burden is seen in Figure 1, which shows that two-thirds (nearly 66%) of all filers in New York State — those earning below $50,000 — are projected to pay just 3.8% of all personal income tax collections this year. Taxpayers earning between $50,000 and $200,000, or about 30% of all filers, are projected to pay just over 35% of all personal income tax collections. Taxpayers earning over $200,000 — comprising just 4.1% of all filers — are projected to pay more than 61% of all income tax collections in 2011.

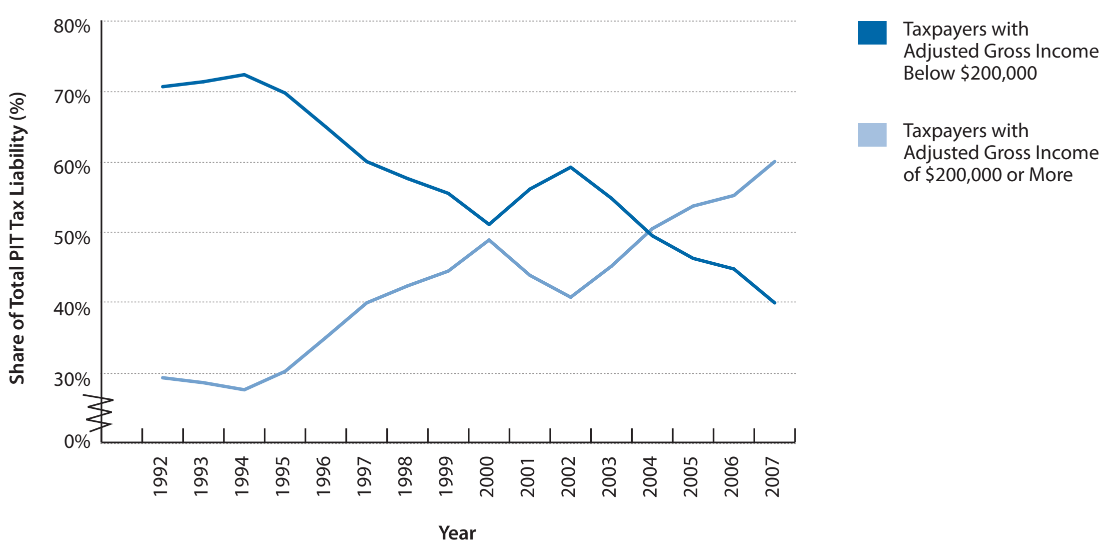
The rapid trend toward increased reliance on a small number of high earner taxpayers is alarming. As illustrated in Figure 2, the share of total personal income tax revenues paid by resident taxpayers earning less than $200,000 has gone from about 71% in 1992, to only 40% in 2007. By contrast, the share of liability among those earning at least $200,000 has grown from about 29% to 60% in this time period.

People are leaving the state and going to places where the tax burden is less. Between 1998 and 2008, a net total of more than 1.7 million New Yorkers chose to relocate, taking with them their wealth and talent. More income has left New York than any other state in the nation — $71.7 billion from 1993 to 2008. For every dollar that migrated into New York from other states during that period, $1.71 left — the highest of any state.

Between 1999 and 2008, according to a study by the Center on Wealth and Philanthropy, the average net worth of households leaving New York State was roughly $338,000. For those households moving from New York to Connecticut and New Jersey the average net worth was about $625,000 and nearly $653,000, respectively.

A significant portion of the relocation from New York was to Florida and Texas, two states with no state or local income taxes, a very low cost of living, and a reasonable

Figure 2. Share of Income Tax Liability Among Full-Year New York State Residents by Income Group



and predictable regulatory environment in which to conduct business. Both states have prospered as a result (see Figure 3).

New York's high taxes risk pushing jobs, tax revenue, and talent to neighboring states like Connecticut with friendlier tax environments for business. Personal and corporate income tax rates in New York City are around double those in Connecticut. Many financial firms are set up as partnerships that are also subject to New York City's four percent unincorporated business tax. (See Figure 4).

Since the imposition of New York's surcharge in 2009, there has been a 9.4% decrease in the state's taxpayers who are worth $1 million or more, decreasing from 381,786 in 2007 to 345,892 in 2009.

At the top of the revenue generators are 1,406 resident taxpayers who have incomes over $10 million and are assessed a surcharge equal to, on average, almost $742,000 a year. If just 10% or 140 of these taxpayers were to leave the state, New York would see an estimated loss of up to $452 million in total personal income tax revenues.

Figure 3. Different Tax Policies, Different Outcomes: New York versus Texas and Florida

	Texas	Florida	New York
Top marginal income tax rate	0.0%	0.0%	8.97%[1]
Top marginal corporate income tax rate	0.0%	5.5%	7.1%[2]
Absolute domestic migration cumulative 1998-2008	+735,816	+1,324,743	-1,700,021
Number of Fortune 500 companies headquartered in the state, 2010	57	16	56
Gross State Product growth between 1998 and 2008	86%	78%	67%
Rank on the 2011 State Business Tax Climate Index, which ranks from 1 (best) to 50 (worst) the tax systems of the 50 states[3]	13th	5th	50th
Rank of the state's economic performance, 2010[4]	3rd	6th	37th
Rank of the state's economic outlook, 2010[5]	19th	5th	50th

(1) New York State's top marginal income tax rate is 8.97% but residents of New York City pay up 12.85% (when city and state tax burdens are combined) — the highest in the nation.
(2) New York State's top marginal corporate income tax rate is 7.1% but businesses in New York City pay up to 15.95% (when city and state tax burdens are combined).
(3) The Tax Foundation's 2011 State Business Tax Climate Index compares the states in five areas of taxation that impact business: corporate taxes; individual income taxes; sales taxes; unemployment insurance taxes; and taxes on property, including residential and commercial property.
(4) American Legislative Exchange Council's economic performance rank is a historical measure based on a state's performance (equally weighted average) in personal income growth, absolute domestic migration, and employment growth.
(5) American Legislative Exchange Council's economic outlook rank is a forecast based on a state's standing in 15 important state policy variables including tax rates and burdens.

Figure 4. Comparison of New York City and Connecticut Income Taxes

	New York City	Connecticut
Top marginal personal income tax rate	12.85%	6.50%
Top marginal corporate income tax rate	15.95%	7.50%
Unincorporated Business Tax rate	4%	N/A

The only solution to New York State's budget and economic challenges are fundamental reforms that reduce both taxes and spending. The surcharge extension would be a palliative to get the state through one budget cycle without taking the actions that are necessary to set the state on a healthy fiscal and economic course for the future.

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