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This committee has chosen an opportune moment to review New York's state tax code and consider reform options.

Wall Street, the state's cash cow for 20 years, is now retrenching. And in an era of slower economic growth, many businesses will be less willing to shoulder costs they can avoid by moving elsewhere. Needless to say, by various measures, most states can offer a lower-cost environment than New York. We cannot continue to presumptuously rely on our other competitive advantages while ignoring the high tax toll the state imposes on entrepreneurs, in particular.

Unfortunately, the state has enacted a series of major tax increases since 2009, including its largest single income tax hike since the 1960s. Only a portion of that increase was rolled back by the temporary tax law changes of 2011. In fact, the 2013-14 state budget effectively extended a net $5 billion in supposedly temporary tax increases over the next four fiscal years.

Meanwhile, despite last December's fiscal "cliff" deal in Washington, tax policy on the federal level remains unsettled. President Obama and congressional Republicans disagree on many issues – but both the President and the House leadership have signaled that they would favor a significant curtailment, if not outright elimination, of the federal income tax deduction for state and local taxes for filers in the highest income brackets. This would further raise the effective, post-deductibility tax price of New York, which is already near an all-time high – making us even less competitive.

New York last enacted a true, structural tax reform since 1987. Since the enactment of the 1995 Tax Relief Act—New York's last significant broad-based tax cut—the general drift of state tax policy in New York has been toward t*argeted* tax breaks. The result is a tax code increasingly cluttered with credits, deductions and other loopholes, driven more by short-term policy goals and political considerations than by the basic principles of tax fairness, efficiency, simplicity, visibility and competitiveness.

The epitome of this tendency is the newly enacted program known as "START-UP NY." The tax breaks offered through this program will be micro-targeted to college campuses and sites near campuses – necessarily entailing a complex, multi-step planning and application process ultimately controlled by the Executive Chamber.

I would respectfully suggest that it's time to turn away from targeting and to place a renewed emphasis on developing a state tax code designed to encourage *all* businesses to come to New York or to *stay* in New York, encouraging them to invest, to hire and to grow *anywhere* in New York that suits their purposes … and, as part of this change, to reverse policies that encourage some economically successful New Yorkers to take their capital elsewhere.

I'd like to summarize some recommendations in key tax areas – starting with the personal income tax, New York's largest revenue source.

A quick review of recent developments in this area: In 2009, the Legislature temporarily raised New York's top income tax rate from 6.85 percent to 8.97 percent on incomes starting as low as $200,000. That increase was scheduled to sunset at the end of 2011. In December 2011, a temporary higher rate of 8.82 percent was extended for three more years on incomes starting at $1 million for individuals and $2 million for couples – but continued to apply as a flat tax to <u>all</u> taxable income, not just to income above those thresholds. As part of the current state budget, the sunset of that so-called "millionaire tax" – a not-insignificant 29 percent increase equating, at minimum, to an extra $39,400 more for couples at the bottom of the bracket — was pushed out to 2017.

The temporary changes of the past several years were added to a PIT code that has become more complex and opaque since the enactment of the Tax Relief Act of 1995. For example, the IT-201, New York's income tax long form, now takes up four pages—twice as many as the federal 1040 form, not including the extra paperwork necessary to claim more than 30 separate income tax credits. The state should be moving in the opposite direction, back towards a simpler, flatter tax structure. Three immediate recommendations:

1. Immediately begin phasing out the added "millionaire" bracket of 8.82 percent. Commencing with the 2014-15 budget, the rate should drop by at least 0.5 percent a year, culminating in a sunset at the end of tax year 2017.
2. Permanently enact the temporary provision "indexing" to inflation all tax brackets, personal exemptions and standard deductions.
3. Aim to achieve a simpler, more efficient and competitive tax structure by broadening the tax base, reducing allowable deductions and while expanding personal exemptions and pulling down the marginal rate.

I'd like to turn now to New York's **Estate Tax.** New York is one of only 19 states that continue to impose either an inheritance tax or estate tax, or both – leaving us at a significant competitive disadvantage. The estate tax, imposed at a rate of 16 percent on estates valued at over $1 million, is particularly harmful to owners of family businesses and farms. Even though the amount of the tax is based on asset value, the simple fact is that it ultimately must be paid out of income.

Senator DeFrancisco has proposed taking an important first step in the right direction by raising the taxable threshold for estates from $1 million to conform to the federal level of $5 million. The revenue impact would be negligible.

But we need to go further. The goal should be nothing less than a phased-in elimination of the Estate Tax. Because it raises $1 billion a year, the repeal obviously will have to be phased in. Keep in mind, however, that the revenue from this tax is offset to an unknown degree by ongoing economic and revenue losses that result from encouraging high net worth households to move elsewhere.

With a maximum rate of 7.1 percent, our **Corporation Franchise Tax** is lower than those of neighboring states. However, it should be noted that a 30-year-old (but still technically "temporary") mass transit surcharge raises the corporate rate to 8.3 percent throughout the 12 county downstate region, including New York City.

As you know, many businesses now have a choice of organizing in ways that subject them to either personal income tax or the corporate tax. To achieve true economic neutrality, one tax reform goal should be to align all income tax rates, personal and corporate, at the same level. One way to achieve this goal would be commit the state to a steady, long-term, ongoing across-the-board reduction in all taxes on business income and receipts, excluding only the petroleum business tax. Each year, the state would budget a fixed amount for this purpose, with the immediate goal of dropping the statewide rate to 6.85 percent. The ultimate goal should be to reduce the statewide tax to an absolute minimum.

When county and New York City rates are included, New York also has one of the nation's highest **Sales and Use Taxes**. By broadening the taxable base—to include, for example, personal and professional services now exempt from the tax—you could raise enough revenue to put a dent in the current rate, which typically is at least 8 percent in most of New York.

In addition, assuming enactment of the proposed federal "Main Street" legislation clearing the way for uniform taxation of online sales throughout the country, the Legislature should (a) direct the Department of Taxation and Finance to report within a year on the amount of added revenue raised by online taxes, and based on that finding (b) commit itself to reducing the sales tax rate by the same amount. For example, if it is determined that online use taxes will generate $600 million in revenue, or about 5 percent of current sales and use tax collections, the state rate could be reduced to 3.8 percent, and local rates could be reduced by like amounts.

These recommendations are just a start, of course. The priorities I've cited just scratch the surface. However, these hearings represent an encouraging step back on the road to true tax reform in Albany. Thank you again for the opportunity to testify.