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Governor Cuomo's 2014-15 Executive Budget would devote more resources to initiatives described as "tax cuts" than any state budget we've seen in quite a few years. This in itself is an encouraging sign of the recognition that New York needs to do more to shed its reputation as a high-cost, high-tax state.

Unfortunately, not all of the actions proposed by the Governor would actually result in a net reduction of New York's state and local tax burden. More than half of the recurring value[1] of his total tax package would be devoted to "property tax relief" measures that would simply shift some of the tax burden from the local level to the state level.

By way of identifying alternatives, I would like to highlight five tax priorities identified in a joint statement issued in December by the Empire Center and the Tax Foundation:

1. Immediately begin a phase-out of the temporary personal income tax increase on high-income earners, with the goal of reducing the top rate in stages from the current 8.82 percent to the permanent-law level of 6.85 percent by 2017;
2. Permanently enact the temporary middle-class income tax cuts that were first enacted in December 2011 and are now scheduled to sunset in 2017;
3. Permanently index the state personal income tax code to inflation;
4. Increase the exemption of the New York Estate Tax to match the federal level of $5.25 million; and
5. Permanently enact the 2 percent local property tax levy cap.

Governor Cuomo's budget addresses just one item on that list—estate tax reform. This is an important step in the right direction, for reasons I will explain in a moment. In addition, the proposed merger of the corporate and bank taxes is a welcome modernization of the tax code, and the proposed across-the-board cut in corporate rates will at least benefit all payers subject to the tax, unlike targeted cuts.

However, the budget's failure to address the temporary provisions of the personal income tax is especially glaring at a time when the governor says the state can afford to enact tax cuts and property tax subsidies that will be worth more than $2.5 billion in 2017-18. As it happens, this sum also represents a sizable chunk of what you would need to phase out most of the so-called "millionaire tax" and permanently enact middle-class tax cuts. The Executive Budget effectively would finance permanent new "tax cuts" with the revenue raised from a sizable temporary <u>increase</u> in the state's largest tax.

The personal income tax is an integral part of the business tax climate because a significant number of firms, including sole proprietorships, partnerships, and S corporations, are subject to this tax. New York City imposes an added resident income tax of up to 3.9 percent, which brings the total rate in the city to 12.8 percent, second highest in the country. The city also imposes an unincorporated business tax of 4 percent, which hits both resident and non-resident participants in pass-through entities.

The temporary statewide top rate of 8.82 is a hair below the previous temporary rate enacted in 2009, but it is higher than any permanent PIT rate imposed by New York since the historic bipartisan state income tax reform of 1987. It is among the highest top rates imposed by any state with an income tax. As a result, in 2014, the Budget Division projects 43 percent of PIT receipts will be owed by the highest-earning 1 percent of filers—equivalent to their peak share of 2007, although their incomes haven't recovered to 2007 levels after falling 40 percent in the recession.

The state needs to wean its budget from over-reliance on the income gains of the wealthy—which the Assembly Majority Ways & Means staff has called an "inherently unstable," "volatile" and "unsustainable" revenue source. New York needs a more competitive, broadly based, predictable and permanent income tax structure.

It's also time to permanently enact the property tax cap— by removing the conditional 2016 sunset date from the current tax cap law. The cap on tax levies is the single most important step New York State ever has taken to bring about a long-term reduction in its extraordinarily high property tax burdens. Making the cap permanent would reassure homeowners and business—existing and potential—that New York is seriously committed to becoming more competitive.

The state is already diverting $3.4 billion in annual personal income tax receipts to homestead property tax exemptions and New York City income tax reductions under STAR—the largest such program in the country. Instead of spending upwards of $1 billion more to subsidize high local taxes, the state should pursue the cost-free alternative of mandate relief to help localities more effectively reduce costs.

Finally, I'd like to turn to one of the most positive elements of the governor's tax agenda —his proposal to reform the estate tax.

The national landscape of estate taxation has changed considerably since 2001, when the federal government began to phase out the tax credit that effectively picked up the cost of the estate taxes then imposed by all 50 states. Most states, including California, Texas and Florida, responded to the federal change by allowing their own estate taxes to disappear during the past decade. New York is among a dwindling number of holdouts – one of only 14 states that still impose any tax on the value of property and financial assets left to heirs by their deceased residents.

The federal death tax, which was restructured in 2011 and revised in 2013, currently applies to estate assets exceeding $5.25 million, which will automatically rise with inflation. New York, however, imposes a death tax on estates with gross values starting at the fixed level of $1 million.

The federal death tax was simplified and reduced from prior permanent-law levels under reforms first enacted in 2011 and revised in 2013. However, New York taxes estates under the far more onerous rules of the pre-2001 federal law—adding to the already high cost of estate tax compliance. In 2012, federal taxes were owed by 3,738 estates throughout the country. That same year, New York State collected taxes from more than 4,000 estates.

While the state death tax hits about 10 percent of all estates admitted to probate in New York, it overshadows the future legacies of a much larger number of current New York residents, including tens of thousands of small business owners and farmers. More than 429,000 New York households have "investable assets" of over $1 million, excluding real estate, according to one study.[2] This is at least 10 times the number of state resident households with annual incomes above $1 million.

New York's death tax has made us an outlier among competing states, providing too many older residents with yet another reason to "move to die," as Governor Cuomo has put it. There is evidence that some will do just that.[3] Others, especially farmers and small business owners, have assets rooted in New York, and the estate tax threatens to diminish the value of what they would prefer to pass along to heirs in New York. They can pay consultants to help devise transition and estate plans to minimize the tax, but as one dairy farmer put it: "These are costs that don't make any more milk, grow any more corn or pay another employee, or anything else you need. It's all just to stay in existence and not have to sell off a section of property just to pay estate taxes."

To counter that message, the Executive Budget would reform the Estate Tax in two significant ways: phasing in an increase in the basic exemption to match the federal threshold, and cutting the top death tax rate to 10 percent from the current 16 percent.

The governor's proposal doesn't completely line up with the provisions of the federal law. On balance, however, it can be viewed as a crucial first step towards the ultimate elimination of the tax – which is the only way New York will become truly competitive with most other states.

In conclusion, tax policy in New York should be guided by Governor Cuomo's first State of the State message: "We have to hold the line on taxes for now and reduce taxes in the future. New York has no future as the tax capital of the nation."

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[1] The proposed property tax circuit breaker and renters' credit will represent $1.4 billion of roughly $2.5

[2] Phoenix Marketing International, "Ranking of U.S. States by Millionaire Per Capita, 2006-2013," at http://w3.phoenixmi.com/wp-content/uploads/2014/01/Phoenix-GWM-U.S.-Ranking-States-By-Millioinaires-Per-Capita-2006-13.pdf

[3] The governor's Tax Reform and Fairness Commission reported that, during its 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." See, also, Jon Bakija and Joel Slemrod, "Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns," at www.nber.org/papers/w10645, and Connecticut Department of Revenue Services, Estate Tax Study, February 2008, at http://www.ct.gov/drs/lib/drs/research/estatetaxstudy/estatetaxstudyfinalreport.pdf