THE TAX REFORM THAT WASN'T

E.J. McMahon[*]

[*] Senior Fellow with Manhattan Institute and its Empire Center for New York State Policy.

INTRODUCTION

In December 2011, Governor Andrew M. Cuomo and leaders of the state legislature agreed to amend New York's personal income tax code by extending almost all of a soon-to-expire rate increase on taxable incomes of at least $1 million (or $2 million for married joint filers), and by slightly reducing marginal rates on taxable incomes below $150,000.[1] The net effect was to generate nearly $2 billion in added revenue, the bulk of which was used to help close a growing state budget gap in 2012–13.[2]

Having previously resisted calls to raise taxes on high-income earners, Governor Cuomo offered a new policy justification for tinkering with the tax code. Changes were needed, he said, to restore "fairness" to an income tax structure under which, as his legislative memorandum put it, "regardless of differences in income, New Yorkers [were paying] tax at very similar rates."[3]

This premise was incorrect, however. Under New York's permanent income tax code, those at the top of the income pyramid already paid a much larger share of their income in taxes than those in the middle and at the bottom.[4] Indeed, national studies described the distribution of the New York personal income tax burden as more progressive than those of most states with income taxes.[5]

The December 2011 income tax amendments, which temporarily created three new tax brackets, did not represent fundamental "tax reform" in the normal sense of the term. Before deciding whether to extend these tax changes, the governor and legislature should more carefully reappraise the entire income tax code in light of the generally accepted tax policy goals of

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[1] *Compare* N.Y. TAX LAW § 601 (McKinney 2006 & Supp. 2012), *with* Act of Dec. 9, 2011, ch. 56, 2012 N.Y. Laws 1521, 1522 (codified as amended in N.Y. TAX LAW § 601 (1)(A)). *See also* Press Release, Governor Andrew M. Cuomo, Majority Leader Skelos & Speaker Silver Announce Comprehensive Plans to Create Jobs and Grow the Economy (Dec. 6, 2011), *available at* http://www.governor.ny.gov/ press/1262011GrowTheEconomy [hereinafter Leadership Press Release 2011].

[2] Leadership Press Release 2011, *supra* note 1.

[3] Sponsor's Memorandum, N.Y. State Senate, in Support of S. 50002, 2011 Leg., 234th Reg. Sess. (N.Y. 2011), *available at* http://open.nysenate.gov/legislation/bill/S50002-2011.

[4] CARL DAVIS ET AL., INST. ON TAXATION & ECON. POLICY, WHO PAYS? A DISTRIBUTIONAL ANALYSIS OF THE TAX SYSTEMS IN ALL 50 STATES 80–81 (3d ed. 2009), *available at* www.itepnet.org/whopays3.pdf.

[5] *Id.* at 3.

equity, simplicity, stability and promotion of economic growth.

To place the December 2011 legislation into a broader historical context, this article provides a summary and overview of the state personal income tax code, with a particular focus on changes enacted since the late 1970s. It concludes with a review of the latest tax changes and of the need for further reform in the near future.

I. THE IMPORTANCE OF THE INCOME TAX

The personal income tax (PIT) is the primary revenue source for New York's state government, generating more than 60 percent of the state's tax receipts as of fiscal years 2010–11 and 2011–12.[6] The PIT, as set forth in article 22 of the state Tax Law, is also the broadest and most pervasive tax imposed by any level of government in the Empire State.[7]

The tax applies to nearly all income earned by residents of New York State, and to wages and salaries earned in New York by residents of other states. The state's income tax structure closely conforms to the definitions of adjusted gross income and deductions set forth in the federal Internal Revenue Code, with some modifications.[8]

Since two-thirds of the state budget is comprised of grants to local governments,[9] the income tax is a substantial indirect source of revenue for municipalities and school districts, as well as for the state government itself. As of fiscal year 2009, the $36

[6] N.Y. STATE DIV. OF THE BUDGET, 2011–12 EXECUTIVE BUDGET: ECONOMIC AND REVENUE OUTLOOK 185 (2011), *available at* http://www.budget.ny.gov/pubs/archive/fy1112archive/eBudget1112/economicRevenueOutlook/economicRevenueOutlook.pdf [hereinafter 2011–12 EXECUTIVE BUDGET].

[7] *See id.*; *see also* N.Y. TAX LAW § 601 (McKinney 2006 & Supp. 2012).

[8] *Compare* 26 U.S.C. § 61(a) (2006), *with* 2011–12 EXECUTIVE BUDGET, *supra* note 6, at 186 (noting principal New York modifications to the federal definition of income are "(1) the inclusion of investment income from debt instruments issued by other states and municipalities and the exclusion of income on certain Federal obligations; (2) the exclusion of pension income received by Federal, New York State and local government employees, private pension and annuity income up to $20,000 ($40,000 for married couples filing jointly), and any Social Security income and refunds otherwise included in Federal adjusted gross income; and (3) the subtraction of State and local income taxes from Federal itemized deductions").

[9] *See* N.Y. STATE DIV. OF THE BUDGET, ENACTED BUDGET FINANCIAL PLAN FOR FISCAL YEAR 2012, at 8, 13 (May 6, 2011), *available at* http://publications.budget.ny.gov/budgetFP/2011-12EnactedBudget.pdf (explaining different funding projects for education programs and the like).

billion in net receipts generated by the state PIT comprised 20 percent of all state and local general revenue (other than federal aid) in New York.[10] Only the local property tax accounted for a larger share, generating 23 percent of the total "own source" of the state and local governments.[11]

As of 2010, New York garnered a large share of state tax revenue from its individual income tax, more than any other state aside from Oregon (which has no sales tax).[12] New York is also heavily dependent on taxes harvested from the salaries, business profits, and investment income of its highest-earning income tax filers. As of 2007, the top 1 percent of the income distribution in New York generated 43 percent of state income tax liability[13]—comparable to the distributional progressivity of the federal individual income tax, 40 percent of which was paid by the highest-earning 1 percent of households in 2007.[14] Although the incomes of the wealthiest New Yorkers decreased sharply after 2007, the state's dependence on taxes paid by this segment of the population remained above 40 percent under a temporary tax increase first enacted in 2009.[15]

The steep progressivity of the PIT distribution is not a recent development. As shown below in figure 1, New York's state income tax was among the most progressive in the country even before December 2011 changes to extend a higher rate on higher-income earners while slightly reducing the top rate in middle-income brackets. As a result, the income tax has been—and will remain—the vehicle for a significant redistribution of wealth among different regions of the state as well as among different individuals.[16]

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[10] *See* U.S. CENSUS BUREAU, STATE AND LOCAL GOVERNMENT FINANCES SUMMARY: 2009, at 3, 6 (Oct. 2011), *available at* http://www2.census.gov/govs/estimate/09_summary_report.pdf.

[11] *See id.*

[12] *2010 State Tax Collection by Source*, FED'N OF TAX ADM'R, http://www.taxadmin.org/fta/rate/10taxdis.html (last visited Apr. 1, 2012).

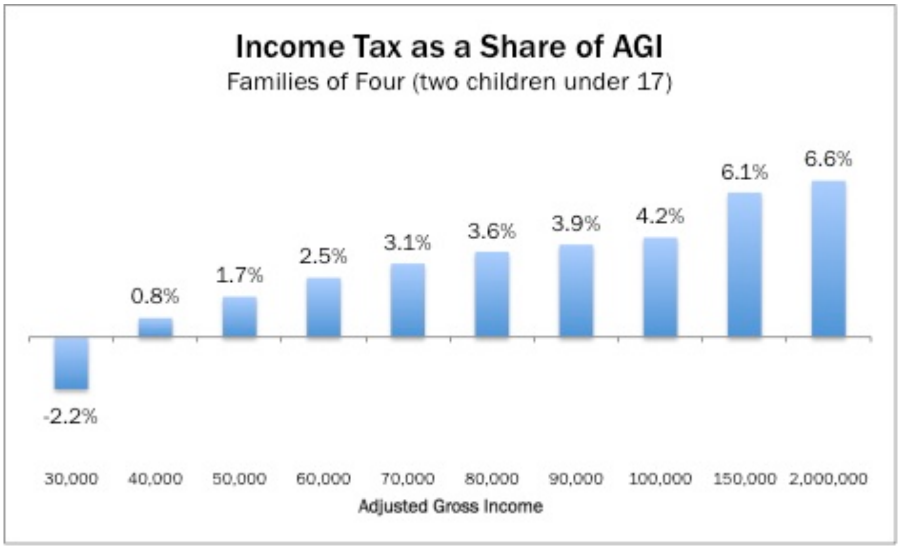
[13] N.Y. STATE DIV. OF THE BUDGET, 2012–13 EXECUTIVE BUDGET: ECONOMIC AND REVENUE OUTLOOK 198 (Jan. 17, 2012), *available at* http://publications.budget.ny.gov/eBudget1213/economicRevenueOutlook/economicRevenueOutlook.pdf [hereinafter 2012–13 EXECUTIVE BUDGET].

[14] CONG. BUDGET OFFICE, AVERAGE FEDERAL TAX RATES AND INCOME, BY INCOME CATEGORY (1979–2007) (June 1, 2010), *available at* http://www.cbo.gov/publication/42870. The federal statistics are based on a measure of household income, while the state distributional shares are computed on the basis of adjusted gross income. *Id.* at 144.

[15] *See* 2012–13 EXECUTIVE BUDGET, *supra* note 13, at 197.

[16] *See* NELSON A. ROCKEFELLER INST. OF GOV'T, GIVING AND GETTING:

Figure 1
Effective Tax Rate for Families of Four* Under Permanent PIT Code



*Married Joint Filers with two children under 17
Source: Taxes calculated using Internet TaxSim Version 8.2, available at http://www.nber.org/~taxsim/taxsimcalc8/index.html. Incomes from $30,000 to $100,000 assumed to use standard deduction; typical itemized deductions assumed for higher income taxpayers.

Changes in PIT rates and in other elements of the income tax structure have significant implications for New York's economic competitiveness and for the long-term stability and sustainability of the state and local revenue base. Since the income tax has also been used as a tool for incentivizing everything from low-wage employment to investments in energy-efficient buildings, changes to the code also can have broader social policy implications.

II. BACKGROUND ON THE PIT CODE

In 1919, New York became the eighth state to adopt a personal income tax.[17] The state PIT was introduced at a top rate of 3

REGIONAL DISTRIBUTION OF REVENUE AND SPENDING IN THE NEW YORK STATE BUDGET, FISCAL YEAR 2009–10, at 4 (Dec. 2011), *available at* http://www.rockinst.org/pdf/nys_government/2011-12-Giving_and_Getting.pdf. Thanks in large part to the PIT, New York's state revenues are disproportionately generated in New York City and its suburbs, resulting in a net transfer of income to upstate. *Id.*

[17] *See* N.Y. STATE DEP'T OF TAXATION AND FIN., NEW YORK STATE TAX

percent on taxable incomes above $50,000—the equivalent of about $650,000 in 2011.[18] During the Great Depression, the top rate peaked at 8 percent.[19] It decreased to 3.5 percent in 1945–46,[20] and was then raised in stages to 7 percent by 1954.[21]

The election of Nelson Rockefeller as governor in 1958 coincided with a series of major changes to New York's personal income tax code. General withholding of state income taxes from wages began in 1959, Rockefeller's first year in office. In 1960, New York's income tax structure was brought more closely into line with the Internal Revenue Code.[22] Rockefeller also initiated a series of significant increases in the top tax rate, which rose from 7 percent as of 1957 to 9.1 percent in 1960, and to 14 percent starting in 1961.[23]

In 1969, the top rate tax was raised to 15 percent. Subsequent temporary surcharges would ultimately raise the top rate to a peak of 15.375 percent in 1972,[24] and again in 1975–76.[25] By the mid 1970s, the graduated rate structure featured fourteen different tax brackets, and New York's top rate was the highest in the country.[26]

The rollback of the Rockefeller-era income tax increases began under Governor Hugh Carey, who took office in 1975. Carey initiated the process as part of his 1978–79 budget, describing the cut in his budget message as "affordable and essential for economic growth."[27] He added: "If we are to provide jobs for our

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SOURCEBOOK 52 (Apr. 2005), *available at* http://www.tax.ny.gov/pdf/stats/policy_special/sourcebook02/new_york_state_tax_sourcebook_april_2005.pdf [hereinafter NYS TAX SOURCEBOOK].

[18] *Id.* at 67; *Databases, Tables & Calculators by Subject: CPI Inflation Calculator*, U.S. BUREAU OF LABOR STATISTICS, www.bls.gov/data/inflation_calculator.htm (last visited Apr. 1, 2012).

[19] NYS TAX SOURCEBOOK, *supra* note 17, at 67.

[20] *Id.*

[21] *Id.*

[22] Warren Weaver, Jr., *U.S. Rules on Tax Adopted by State: Rockefeller Signs Bill That Calls for Using Federal Data on 1961 Forms*, N.Y. TIMES, Apr. 19, 1960, at 1 column 2.

[23] NYS TAX SOURCEBOOK, *supra* note 17, at 67.

[24] *Id.*

[25] *Id.*

[26] *State and Local Tax Burdens: All States, One Year, 1977–2009*, TAX FOUNDATION, http://www.taxfoundation.org/files/sl_burdens_byyear_1977-2009-20110223.pdf (last visited Apr. 1, 2012); N.Y. STATE DEP'T OF TAXATION & FIN.: OFFICE OF TAX POLICY ANALYSIS, PROGRESSIVE IMPROVEMENT 7 (Dec. 1995) [hereinafter PROGRESSIVE IMPROVEMENT].

[27] Roger Wilkins, *Carey's Tax-Cut Plan and Aid to the Poor*, N.Y. TIMES, Feb. 20, 1978, at D4.

people and economic opportunity for our children, we must tear down the wall of high taxes that separates us from the rest of the nation."[28]

About one-third of the tax reduction in Carey's original 1978 proposal would have taken the form of a one-time tax credit.[29] The governor's plan would have left the 15 percent top rate intact while reducing the number of people who paid it.[30] But the senate's Republican majority, under the leadership of Senator Warren Anderson, countered with a proposal for a much larger, permanent tax cut.[31]

The final result was a compromise incorporating some key elements of the Senate Republican plan. The top income tax rate, which previously applied uniformly to all types of income, was bifurcated into different rates for "earned" income from wages and salaries and "unearned" income from capital gains, interest, and dividends.[32] The top rate on earned income was decreased from 15 percent to 12 percent, while the rate on unearned income remained at 15 percent.[33] In 1979, Carey and the legislature agreed to further reduce the top rate on earned income from 12 percent to 10 percent, phasing in the reduction over two years.[34] The 1978 and 1979 income tax cuts also included increases in some personal deductions and exemptions, along with the phased elimination of the separate personal income tax on profits from unincorporated businesses.[35]

Despite these changes, including a full 33 percent reduction in New York's top tax rate on earned income, inflation-adjusted state PIT revenues increased by 6.8 percent between fiscal years 1977–78 and 1981–82.[36] Although some of this reflected economic growth, it also was driven by the phenomenon known as "bracket

[28] *Id.*

[29] *See* Steven R. Weisman, *A Tax-Reduction Agreement That Meets Political as Well as Fiscal Requirements*, N.Y. TIMES, Mar. 23, 1978, at B5.

[30] *See id.*

[31] *See id.*; Richard J. Meislin, *Anderson Proposes Tax-Cutting Plan*, N.Y. TIMES, Mar. 6, 1978, at B8.

[32] *See* NYS TAX SOURCEBOOK, *supra* note 17, at 67.

[33] *Id.* This did not mean all unearned income was taxed at a lower rate than earned income. Because federal tax law allowed a 60 percent exclusion for capital gains, the state's effective top rate translated into an effective rate of 5.6 percent.

[34] *See id.*; *see also* Act of July 11, 1979, ch. 624, 1979 N.Y. Laws (repealed 1987).

[35] *See* Act of May 22, 1979, ch. 108–09, 1979 N.Y. Laws.

[36] *See* PROGRESSIVE IMPROVEMENT, *supra* note 26, at 6–7; STATE OF N.Y., DIV. OF THE BUDGET, NEW YORK STATE BUDGET SUMMARY 1979–80, at 3 (1979).

creep," through which the high inflation rates of the era pushed more taxpayers into higher tax brackets.[37]

III. FOLLOWING THE FEDERAL LEAD

In August 1981, President Ronald Reagan signed into law the Economic Recovery Tax Act,[38] also known as the Kemp-Roth tax cut,[39] which slashed federal income tax rates across the board. The top federal rate dropped from 70 percent to 50 percent, and the federal tax code was for the first time automatically "indexed" to inflation, halting the bracket creep that had pushed millions of middle-income payers into higher brackets during the late 1970s.[40]

New York State ultimately followed suit, albeit to a lesser extent, with the 1985 Tax Act.[41] The top tax rate on earned income was reduced from 10 to 9 percent, and the rate on unearned income was cut from 14 percent to 13 percent.[42] Governor Mario M. Cuomo pronounced himself "very pleased" with the result and he said that "[t]here will be a huge tax cut, larger than even I had hoped for."[43] More was yet to come.

The state was about halfway through the implementation of its 1985 Tax Act when President Reagan and a bipartisan coalition of congressional Republicans and Democrats agreed to enact the historic federal Tax Reform Act of 1986,[44] the most significant overhaul of the Internal Revenue Code in thirty-two years. The base of income subject to tax was significantly broadened through the elimination or curtailment of many tax loopholes and special preferences. At the same time, the graduated rate structure was made flatter. The top federal income tax rate of 50 percent was

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[37] PROGRESSIVE IMPROVEMENT, *supra* note 26, at 8.

[38] Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in 26 U.S.C. § 1 (2006)).

[39] *See* Bruce Bartlett, *What Would Ronald Reagan Do? Who Cares*, WASH. POST, Feb. 5, 2012, at BO3.

[40] *See id.*; PROGRESSIVE IMPROVEMENT, *supra* note 26, at 8.

[41] *See* Act of Apr. 8, 1985, ch. 29, 1985 N.Y. Laws 50 (codified as amended in scattered sections of N.Y. TAX LAW).

[42] 1985 N.Y. Laws 57–58.

[43] *Cuomo and Legislators Agree on Income Tax Cut*, N.Y. TIMES, Mar. 29, 1985, at A1.

[44] Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in 26 U.S.C. § 1 (2006)); George K. Yin, *Dunwody Distinguished Lecture in Law: Is the Tax System Beyond Reform?*, 58 FLA. L. REV. 977, 1032 (2006).

reduced to 28 percent, and capital gains were subjected to the same treatment as all other income.[45]

Due to New York's tight integration with the federal tax code, Washington's reform demanded some tax code adjustment by Albany. If state tax rates had remained unchanged from the levels adopted in 1985, the broadening of the federal definition of adjusted gross income alone would have brought about a significant "windfall" state tax increase estimated at $1.7 billion to $2.3 billion.[46] At the same time, renewed economic growth—reflected in Wall Street's strongest bull market since the 1960s—was yielding a bumper crop of tax receipts, consistently exceeding the state's budget projections.[47]

New York chose to follow up on federal tax reform with the most sweeping and fundamental reform of its state personal income tax code in nearly thirty years.

IV. THE TAX REFORM AND REDUCTION ACT OF 1987

Governor Mario Cuomo initially proposed a limited response to federal tax reform—a set of tax changes designed solely to prevent a windfall tax increase.[48] The governor's plan would have left the maximum rate of 9 percent on all income, while eliminating the differential rate for unearned income.[49] It also would have widened tax brackets, created a new deduction for two-income households, and removed many working poor from the tax rolls through increases in tax credits and the standard deduction.[50]

Senate Republicans under Anderson's leadership offered a more comprehensive plan to cut taxes by a total of $4.5 billion a

[45] Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 101, 301, 100 Stat. 2085, 2096–97, 2216 (codified as amended in 26 U.S.C. § 1). Including a "bubble" that effectively imposed a 33 percent rate on some taxpayers. *See* Gene Marlowe, *Tax "Bubble" Coming Under Fire*, RICHMOND TIMES DISPATCH (Va.), July 23, 1990, at A2.

[46] Marc Humbert, *Tax Panel's Plan Backed by Cuomo *Lawmakers Likely to Battle Over Windfall*, TIMES UNION (Albany, N.Y.), Dec. 7, 1986, at C1.

[47] Alan Finder, *The Higher Math of Tax Cuts*, N.Y. TIMES, Aug. 12, 1984, at 46; Robert Lenzner, *Wall Street is Still Feeling Cocky Despite Big One-Day Drop, Market Watchers Think Rally has a Ways to Go*, BOS. GLOBE, May 4, 1986, at A1.

[48] Humbert, *supra* note 46.

[49] *See* Edward A. Gargan, *Cuomo to Ask Legislature for $1.2 Billion Tax Cut*, N.Y. TIMES, Jan. 7, 1985, at B4.

[50] *See* Maurice Carroll, *Budget Chief Says All Will Benefit From Tax Cut*, N.Y. TIMES, Apr. 4, 1985, at B6.

year, including over $2 billion in net tax cuts beyond the windfall offset.[51] Their plan created a new tax bracket structure, with a top rate of 7 percent on income above $30,000 and a 4 percent on incomes below that amount.[52] The Senate also allowed for a simplified "quick tax" or "short form" for filers choosing not to itemize deductions, imposing a flat rate of 5.5 percent on taxable income.[53]

The most radical tax reform proposal of the 1987 session was introduced by Assembly Speaker Mel Miller and other leading members of the Assembly Democratic majority.[54] Their Fair and Simple Tax (FAST) plan, which was based largely on recommendations of the assembly-controlled Legislative Tax Study Commission, called for eliminating almost all itemized deductions, increasing standard deductions, and replacing the state's multiple bracket structure with a flat rate of 6.75 percent.[55]

What followed was a textbook bipartisan compromise. The resulting Tax Reform and Reduction Act (TRRA) of 1987[56] cut taxes by a total of $4.5 billion, according to contemporaneous estimates, including a net reduction of $2.2 billion beyond the federal windfall offset. Governor Cuomo preferred a smaller tax cut but called the basic elements "acceptable" and "good for the people of the state."[57] It incorporated some of the senate's proposals, but in significant respects it was most similar to the assembly's plan.

Like the FAST plan, the 1987 law eliminated discriminatory treatment of married couples with unequal incomes by establishing a separate filing status for single taxpayers and married joint filers, with a third category for single heads of households with dependents.[58] When fully effective in 1991, it

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[51] Bennett Roth, *GOP Issues $4.5B State Tax-Cut Plan Senate Republican Leaders Propose Personal Tax Rates of 4% and 7%*, TIMES UNION (Albany, N.Y.), Dec. 3, 1986, at B6.

[52] *Id.*

[53] *Id.*

[54] Joseph A. Pechman & Alvin Rabushka, *A Chance to Simplify New York Taxes*, N.Y. TIMES, Mar. 21, 1987, at 127.

[55] *Id.*

[56] Act of Apr. 20, 1987, ch. 28, 1987 N.Y. Laws 67 (codified as amended in scattered sections of the N.Y. TAX LAW).

[57] Mary Connelly & Carlyle C. Douglas, *Albany Agrees on Sweeping Cuts in State Taxes*, N.Y. TIMES, Apr. 5, 1987, at 46.

[58] 1987 N.Y. Laws 68, 70 (codified as amended in N.Y. TAX LAW § 601(a)(1)–(c) (McKinney 2006 & Supp. 2012)).

would have reduced the number of tax brackets from thirteen to two, and cut the top rate from 9 to 7 percent.[59] The top rate would apply to taxable incomes above $12,500 for singles and $27,000 for married joint filers.[60] As proposed by the governor, the senate and the assembly, it followed the lead of the federal reform in treating all income the same, eliminating separate earned and unearned rates.[61]

Standard deductions would be expanded from $3,000 to $13,000 for married joint filers, for example.[62] This, along with an increase in the exemption for dependents, served the dual purpose of delivering low-income tax relief while also simplifying the tax code through the elimination of multiple low-income brackets and targeted credits.

A leading non-partisan tax scholar summarized the 1987 TRRA as follows:

> Prior to the reform acts, the New York personal income tax employed a quixotic mixture of separate and joint filing provisions to adjust tax burdens imposed on individuals. Its relief mechanisms for low-income families were complex and inadequate. Its separate filing rule was impossible to administer fairly and imposed unjustifiable penalties on marital partners who earned substantially unequal incomes. Single parents with dependent children were taxed far more heavily than their economic condition warranted.
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> The reformed system, when fully effective . . . will provide simple and fair tax relief to the poor and will impose substantially equal tax burdens on family members enjoying comparable standards of living. By any reasonable standard, the reform should be judged a success.[63]

The 1987 reform marked a tax policy watershed for New York. After years of careful consideration and debate, both conservative Republicans and liberal Democrats in the legislature embraced a

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[59] *Compare* Act of Apr. 2, 1985, ch. 28, 1985 N.Y. Laws 28, 58 (repealed 1987) (setting maximum income tax from personal service at 9.5 percent), *with* 1987 N.Y. Laws 67, 69–71 (codified as amended in N.Y. TAX LAW § 601) (reducing maximum rate to 7 percent). *See also* E. Parker Brown, II & David P. Blaustein, *State Taxation*, 39 SYRACUSE L. REV. 521, 536 (1988) (discussing the reduction in tax rates and consolidation of brackets in the 1987 statutory amendment).

[60] N.Y. STATE DEP'T OF TAXATION AND FIN., PUB. 900, NEW YORK STATE'S TAX REFORM AND REDUCTION ACT OF 1987: QUESTIONS AND ANSWERS 15 (May 1987).

[61] *Id.* at Commissioner's Opening Letter ("[T]here will no longer be any distinction between earned and unearned income.").

[62] 1987 N.Y. Laws 97, 100–01 (codified as amended in N.Y. TAX LAW § 612).

[63] Michael J. McIntyre, *Tax Justice for Family Members After New York State Tax Reform*, 51 ALB. L. REV. 789, 789 (1987).

flatter, simpler tax rate structure as the centerpiece of their reform agendas.[64] As noted, senate Republicans in 1987 floated a simplified flat-tax option, and assembly Democrats made a flat tax their main proposal.

At that time, a flat tax was not perceived as being in conflict with the goal of tax fairness. Rather, the 1987 TRRA achieved a progressive distribution of the tax burden by combining a flatter tax rate structure with a larger standard deduction, which was intended to serve as a "zero tax bracket" for non-itemizers. The law generally met the assembly's "fair and simple" standard, including Speaker Miller's stated goal of establishing "a progressive tax system that hits taxpayers in the proportion of their ability to pay."[65]

V. REFORM INTERRUPTED, THEN MODIFIED

The changeover to a new tax structure stalled in 1989, after the first two phases of the tax reform were implemented. Confronted with a severe fiscal crisis, Governor Cuomo postponed the implementation of the remaining three phases of the TRRA for five consecutive years, starting in 1990 and continuing through the final year of his tenure in 1994.[66]

Even while the 1987 tax reform was in suspended animation, the chronic budget shortfalls of the early 1990s also gave rise to permanent income tax increase. It took the form of one of the most unusual and poorly understood wrinkles in the New York tax code. Under a standard graduated income tax, a household in the highest tax bracket pays the top rate on just the portion of its income in that top bracket and then lower rates on portions of income falling into the lower brackets, but in July 1991, the legislature passed a "supplemental tax" that converted the top rate into a flat tax on all households earning more than $150,000 a year of adjusted gross income.[67] The benefits of the four graduated tax rates below the top rate were phased out for taxpayers with adjusted gross income between $100,000 and

[64] *See id.* at 802–05.

[65] Kyle Hughes, *Speaker's Tax Plan Makes Cut Likely 6.75% Rate for Individuals Proposed*, TIMES UNION (Albany, N.Y.), Feb. 27, 1987, at 5A.

[66] *See* EDMUND J. MCMAHON, MANHATTAN INST. FOR POLICY RESEARCH, DÉJÀ VU ALL OVER AGAIN: THE RIGHT WAY TO CURE NEW YORK'S LOOMING BUDGET GAP 5 (Oct. 2002), *available at* http://www.manhattan-institute.org/pdf/cr_29.pdf.

[67] Act of July 19, 1991, ch. 410, 1991 N.Y. Laws 3263, 3267–68 (codified as amended in N.Y. TAX LAW § 601(d)).

$150,000.[68]

Since the income thresholds for the supplemental tax did not differ by filing status, it effectively discriminated against married joint filers. This was counter to the goals of the tax reform enacted just four years earlier. It also added complexity to the code, since it required taxpayers with incomes above $100,000 to calculate their tax using a special added worksheet. As of 1991, the supplemental tax increase added $718 to the tax bill of married joint filers with incomes above $150,000.[69] The corresponding increases for single filers and heads of households at the same gross income levels were $359 and $484, respectively.[70] The supplemental tax would remain in effect through all subsequent changes to the tax code.

Two other important personal income tax changes took effect during the TRRA interregnum in the early 1990s. The first, targeted at affluent households, was a new federal limitation on itemized deductions, to which New York automatically conformed. Effective in 1991, the change limited the deductions to taxpayers with adjusted gross incomes above an indexed level, initially set at $100,000 a year.[71] The second change, affecting the opposite end of the income spectrum, was the enactment of New York's own refundable Earned Income Tax Credit, linked to the federal credit with the same name.[72] The credit was designed as a supplement for low-wage employment. It was initially set at 7.5 percent of the federal EIC and scheduled to increase to 20 percent in 1997.[73]

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[68] Act of June 12, 1991, ch. 166, 1991 N.Y. Laws 2562, 2616 (codified as amended in N.Y. TAX LAW § 614(b)).

[69] N.Y. STATE DEP'T OF TAXATION & FIN., OFFICE OF TAX POLICY ANALYSIS, PUB. 410: ANALYSIS OF 1992 PERSONAL INCOME TAX RETURNS 4 (May 1995), *available at* http://www.tax.ny.gov/pdf/stats/stat_pit/pit/analysis_of_1992_personal_income_tax_returns.pdf.

[70] *Id.*

[71] Act of May 25, 1990, ch. 190, 1990 N.Y. Laws 2395, 2504 (codified as amended in N.Y. TAX LAW § 614(b)); *see* Allan R. Gold, *The Budget Agreement: Limits on Deductions Could Raise Bill for Affluent*, N.Y. TIMES, Oct. 3, 1990, at D29.

[72] *See* MAXIMILIAN D. SCHMEISER, INST. FOR RESEARCH ON POVERTY, EXPANDING NEW YORK STATE'S EARNED INCOME TAX CREDIT PROGRAM: THE EFFECT ON WORK, INCOME, AND POVERTY 1 (Aug. 2008), *available at* http://www.irp.wisc.edu/publications/dps/pdfs/dp134108.pdf.

[73] Tom Heinz, Dir. of Audits, N.Y. State Dep't of Taxation & Fin., Presentation at the FTA 72d Annual Meeting: Predictive Modeling and Earned Income Tax Credit (June 7, 2004), http://www.taxadmin.org/Fta/meet/04am_pres/heinz.pdf.

VI. RENEWED REFORM AND TAX CUTS

Governor George Pataki began his first term as governor in 1995 by proposing a four-year, $6.8 billion income tax cut, combining the remaining phases of the 1987 reform with additional tax relief.[74] His bill called for a top rate of 5.9 percent, which would apply to a taxable income threshold of $50,000 for married joint filers.[75] Pataki's ultimate compromise with the legislature, the 1995 Taxpayer Relief Act, was a three-year, $3.6 billion tax reduction package that lowered the top rate to 6.85 percent, slightly below the original target level of the 1987 reform.[76] It retained the 1989 structure of five brackets, with a starting rate of 4 percent, in place of the flatter two-bracket rate structure that would have been the end result of the TRRA.[77] However, the 1995 law also raised the top rate taxable income threshold for joint filers to $40,000, a full one-third higher than the level approved in 1987.[78] Standard deductions were also expanded to the full levels promised by the 1987 reform: $13,000 for married joint filers, $7,500 for single filers and $10,500 for heads of households.[79]

The 1995 Tax Relief Act dropped 500,000 low-income filers from the rolls by accelerating the phase-in of an EIC set at 20 percent of the federal level.[80] It provided the vast majority of filers with an average cut of 25 percent—nearly double the reduction for high-income households, which benefitted principally from the 13 percent reduction in the top rate.[81]

Because a disproportionate share of the tax relief under the 1995 Tax Relief Act was targeted to low and middle income households, the distribution of the tax burden quickly became more progressive than it had been (i.e., a larger share of the tax was paid by filers with high incomes). This progressivity was

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[74] *See Summary of Major Actions in the Legislature's 218th Session*, N.Y. TIMES, July 9, 1995, at 28.

[75] Letter from Michael H. Urbach, Comm'r of Taxation & Fin., N.Y. State Dep't of Taxation & Fin., to George Pataki, Governor of N.Y. (June 7, 1995), *available at* http://image.iarchives.nysed.gov/images/images/124282.pdf.

[76] Act of June 7, 1995, ch. 2, 1995 N.Y. Laws 42, 42–43 (codified as amended in N.Y. TAX LAW § 601 (a)); PROGRESSIVE IMPROVEMENT, *supra* note 26, at 1.

[77] PROGRESSIVE IMPROVEMENT, *supra* note 26, at 17.

[78] *Id.*

[79] N.Y. State Dep't of Taxation & Fin., Technical Mem. TSB–M–87(II)I (Sept. 25, 1987), *available at* http://www.tax.ny.gov/pdf/memos/income/m87_ 11i.pdf.

[80] *See* PROGRESSIVE IMPROVEMENT, *supra* note 26, at 17.

[81] *See id.* at 1.

further enhanced by a series of changes over the next eleven years, including:

- An expansion of the standard deduction for married joint filers, from $13,000 as of 1997 to $15,000 as of 2006.[82]
- An increase of the EITC, from 25 percent to 30 percent of the federal credit, phased in between 2001 and 2003.[83]
- Creation of the Empire State Child Credit in 2006, equal to $100 multiplied by the number of children aged 4 to 16 who qualify for the federal credit, or 33 percent of the credit.[84]

Figure 1 above illustrates the progressivity of the state income tax as applied to families with children. As shown, the effective rates on families of four with two dependent children as of 2007 ranged from negative 2.2 percent on an income of $30,000 (i.e., the couple received a tax refund of $660) to 3.1 percent on a family with income of $70,000 (roughly the statewide median) to 6.6 percent on a family with four with income of $2 million (assuming average deductions for each income category).[85]

VII. TEMPORARY TAX INCREASES

In 2003, the legislature and Governor Pataki were divided over how to close the large budget gap that developed during the aftermath of the 9/11 terrorist attacks, a national economic recession and a sharp downturn on Wall Street. Over the governor's veto, the legislature enacted a three-year temporary increase to raise up to $1.6 billion a year.[86] The highest bracket, set at 7.7 percent, applied to taxable incomes above $500,000 for all filers. The second highest bracket of 7.5 percent applied to incomes above $150,000 for married filers (or $100,000 for singles

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[82] Press Release, Sheldon Silver, N.Y. State Assembly Speaker, Assembly Unveils Tax Cut Proposal: Benefits Working Families & Targets Job Creation (Mar. 14, 2000), *available at* http://www.assembly.state.ny.us/Press/20000314.

[83] V. Joseph Hotz & John Karl Scholz, *The Earned Income Tax Credit*, *in* MEANS—TESTED TRANSFER PROGRAMS IN THE UNITED STATES 141, 150–51 (Robert A. Moffit ed., 2003), *available at* http://www.nber.org/chapters/c10256.pdf.

[84] *Empire State Child Credit*, N.Y. STATE DEP'T OF TAXATION & FIN. (Nov. 25, 2011), http://www.tax.ny.gov/pit/credits/empire_state_child_credit.htm.

[85] *See supra* Figure 1.

[86] ALAN G. HEVESI, N.Y. STATE OFFICE OF THE STATE COMPTROLLER: OFFICE OF BUDGET & POLICY ANALYSIS, 2003–04 BUDGET ANALYSIS: REVIEW OF THE ENACTED BUDGET 26–27 (June 2003), *available at* http://osc.state.ny.us/reports/budget/2003/enactedbudgetreport.pdf; Joe Mahoney, *Gov Nixes City Bailout: But Pols Override Pataki's Vetoes of State Budget*, DAILY NEWS (N.Y.), May 16, 2003.

and $125,000 for heads of households).[87] The top rate was scheduled to remain in effect for three years; the second-highest rate was reduced to 7.375 percent in 2004 and 7.25 percent in 2005.[88] To maximize the revenue yield from these increases, the legislature replicated the flat-tax approach of the 1991 supplemental tax increase. For affected filers, the higher rates applied as a flat tax to every dollar of taxable income. The impact was thus much greater than that of a standard marginal rate.[89]

The temporary tax was first reflected in state income-withholding tables during the spring of 2003, effective with the same payroll cycles as a sharp reduction in federal withholding rates brought about by the acceleration of the 2001 Bush tax cuts. The net result was a significant immediate decrease in the combined state and federal income tax bill, even for those targeted by New York's temporary rate increases.[90] The economy recovered more quickly than expected, and revenues on the state level surged as financial markets entered another bull phase (which turned out to be a bubble). As a result, there was no serious effort by either house of the legislature to extend the sunset on New York's temporary tax increases after they expired at the end of 2005. For three years, from 2006 through 2008, the New York State income tax returned to its permanent-law levels for all income groups.

The recession that began in December 2007 and the Wall Street meltdown in the fall of 2008 created severe fiscal problems for states across the country. In New York, Governor David Paterson and the legislature agreed to more than $6 billion in tax and fee increases, including a temporary three-year income tax increase, targeted at high-income filers.[91] The top rate was raised to 8.97 percent on filers with taxable incomes above $500,000,

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[87] Act of May 15, 2003, ch. 62, 2003 N.Y. Laws 2062, 2531–35 (codified as amended in N.Y. TAX LAW § 601(a)–(d) (McKinney 2006 & Supp. 2012)).

[88] 2003 N.Y. Laws 2531–32.

[89] Fiscalwatch Memo, *New York's Ugly Stealth Tax Hikes*, MANHATTAN INST. (June 9, 2003), http://www.nytorch.com/html/fwm_2003-07.html.

[90] *See* E.J. MCMAHON, MANHATTAN INST. FOR POL'Y RESEARCH, THE $36 BILLION BONUS: NEW YORK'S GAINS FROM FEDERAL TAX CUTS 4–5 (Aug. 2004).

[91] Act of Apr. 7, 2009, ch. 57, 2009 N.Y. Sess. Laws 392, 394, 396 (McKinney) (codified as amended in N.Y. TAX LAW § 601); *Can New York Depend on a "Millionaire's Tax" to Solve the Budget Crisis?*, PARTNERSHIP FOR N.Y.C. (Feb. 2011), http://www.pfnyc. org/reports/2011-Personal-Income-Tax.pdf [hereinafter PARTNERSHIP FOR N.Y.C.]; Mark C. Kriss, *2010 Legislative Preview*, N.Y. STATE SOC'Y OF PROF'L ENGINEERS, http://www.nysspe.org/legupdate2010a.php (last visited Apr. 1, 2012).

and to 7.85 percent on single filers earning at least $200,000 and married joint filers earning taxable incomes of at least $300,000.[92] As in 2003, the temporary brackets applied the 1991 supplemental tax methodology to recapture the benefits of lower graduated rates, converting the higher rates into flat taxes applicable to every dollar of taxable income.[93] In 2011, the temporary tax raised about $4.6 billion in net annual revenue, or nearly three times as much as the 2003–05 temporary tax.[94] Although most of the people subject to 2009 increase had incomes below $1 million, the temporary brackets were often referred to as a "millionaire tax."[95]

VIII. A TAXING TURNABOUT

Governor Andrew Cuomo's first budget closed a $10 billion gap without tax increases, leaving untouched the scheduled December 31, 2011 expiration of the temporary income tax brackets.[96] The top state income tax rate was scheduled to return to its permanent-law level of 6.85 percent in 2012. However, in the months following the adoption of the state budget in March 2011, the extension of the temporary tax increase became the highest priority of public-sector labor unions and other advocacy groups opposed to further spending cuts.[97] As a symbolic measure, in May 2011 Assembly Speaker Sheldon Silver introduced a one-year extension of the top rate for those earning taxable incomes of more than $1 million.[98]

From the outset of his 2010 gubernatorial campaign, Andrew Cuomo was opposed to extending the temporary tax. "I was against it at the time, and I still am," the then-attorney general

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[92] 2009 N.Y. Sess. Laws 392, 396.

[93] PROGRESSIVE IMPROVEMENT, *supra* note 26, at 6, 14.

[94] *See* 2012–13 EXECUTIVE BUDGET, *supra* note 13, at 198 tb.7 (comparing liability for all taxpayers in 2011 under the former rates and the new law beginning in 2012).

[95] PARTNERSHIP FOR N.Y.C., *supra* note 91.

[96] ANDREW M. CUOMO, BUILDING A *NEW* NEW YORK: ONE YEAR PROGRESS REP. 1 (2012), *available at* www.governor.ny.gov/assets/1yrprogressreport.pdf; *See* Erik Kriss & Sally Goldenberg, *"Tax the Rich" Union Rally Push to Keep State Levy*, N.Y. POST, Oct. 26, 2011, at 2.

[97] Christopher Robbins, *72% of Voters Want to Extend NY's "Millionaires Tax" Despite Cuomo's Objections*, GOTHAMIST (Oct. 17, 2011, 3:17 PM), http://gothamist.com/2011/10/17/72_of_voters_want_to_extend_nys_mil.php; s*ee generally* Kriss & Goldenberg, *supra* note 96.

[98] Assem. 7802, 2011 Leg., 233rd Reg. Sess. (N.Y. 2011).

said in June 2010.[99] "It's a new tax. It was supposed to sunset. If it doesn't sunset, it's a tax."[100] Through the first ten months of 2011, Governor Cuomo continued to oppose such tax increases on the grounds they would harm the state's economic competitiveness.[101]

In the fall of 2011, as the state comptroller's monthly cash reports pointed to further erosion in the state's financial outlook, the Governor apparently began to change his position on taxes. At the end of November, news reports suggested the Governor was negotiating with lawmakers to come back for a special session to revisit the tax increase, among other issues.[102] This was confirmed in early December, when the Governor began to stress a new tax policy priority: fairness.

"Our current tax system is . . . unfair," Governor Cuomo said in an op-ed article distributed two days before the legislature's December 7 special session.[103] He continued:

> [I]n New York under the permanent tax code, an individual making a taxable income of only $20,000 pays the same marginal tax rate as an individual making $20 million. It's just not fair. While New York's earned income tax credit, child care credit, and high standard deduction help working poor families, New York has left the middle class with an undue burden which also hinders our economic recovery.
>
> From a competitive point of view, New York's tax system is behind. Other states and the federal government have an income tax code that is fairer than New York's. Unlike New York, 22 states apply their highest rate to incomes higher than our $40,000 level. Also, unlike New York, where the range between its lowest rate (4%) and its highest rate (6.85%) is only 2.85%, 28 other states have larger ranges that reflect a fairer distribution of the tax

[99] Jacob Gershman, *City News: Cuomo: Let Tax Hike Die*, WALL ST. J., June 29, 2010, at A23.

[100] *Id.*

[101] Celeste Katz, *Cuomo: NY "Millionaire's Tax" Still on Deathbed*, N.Y. DAILY NEWS BLOG (Oct. 17, 2011, 1:33 PM), http://www.nydailynews.com/blogs/dailypolitics/2011/10/cuomo-ny-millionaires-tax-still-on-deathbed.

[102] Jimmy Vielkind, *Special Session Still a Real Possibility*, TIMES UNION (Albany, N.Y.), Nov. 29, 2011, at A3; Thomas Kaplan, *Negotiations Under Way for Special Session in Albany on Budget Shortfall*, N.Y. TIMES CITY ROOM BLOG (Dec. 1, 2011, 7:18 PM), http://cityroom.blogs.nytimes.com/2011/12/01/negotiations-under-way-for-special-session-in-albany-on-spending-cuts.

[103] Press Release, Governor Andrew M. Cuomo, Governor Cuomo Op-Ed on Tax Reform, Governor's Press Office (Dec. 5, 2011), *available at* http://www.governor.ny.gov/ press/120511taxoped [hereinafter Gov. Cuomo Op-Ed on Tax Reform].

burden.[104]

Governor Cuomo's denunciation of the rate structure would imply a change in Albany's longtime tax policy focus from effective tax rates (i.e., what people actually pay) to the headline tax table rate. However, tax rates alone can be a highly misleading indicator of true tax burdens.

To pick up on the Governor's example, while a person earning a dollar more than $20,000 in taxable income is subject to the same 6.85 percent marginal rate as an individual with income of $20 million under the permanent tax code, the actual income tax burdens borne by these individuals is much different when measured as a percentage of their adjusted gross incomes. Under the permanent code, a single New Yorker with adjusted gross income (AGI) of $27,501, the minimum amount subject to the top rate, would pay a maximum income tax of $950, or 3.5 percent of AGI. By comparison, as of 2007 (the last pre-recession year under the permanent code), resident tax filers with incomes exceeding $10 million paid an average effective rate of 6.3 percent of AGI.[105] In other words, as a share of total income, a $20 million earner would typically pay nearly twice as much as the individual subject to the top marginal rate under the permanent code Cuomo denounced as "just not fair." For families with children, who receive additional targeted benefits under the tax code, the difference is greater, as shown in Figure 1 of the analysis.

The gap between statutory rates, as highlighted by the Governor, also does not necessarily reflect the level or distribution of taxes. Consider, for example, Table 1 below comparing taxes paid by married joint filers in New York and Maryland under the respective tax codes of those states in 2008, the last year before New York's latest round of temporary increases. The higher the ratio of taxes paid by the $500,000 couple compared to couples in lower incomes, the more progressive the tax treatment of high incomes compared to lower incomes.

[104] *Id.*

[105] N.Y. STATE DEP'T OF TAXATION AND FIN., OFFICE OF TAX POLICY ANALYSIS, ANALYSIS OF 2007 PERSONAL INCOME TAX RETURNS 35 (June 2010), *available at* http://www.tax.ny.gov/pdf/stats/stat_pit/pit/analysis_of_2007_personal_income_tax_returns.pdf.

Table 1

Maryland vs. New York Income Taxes: Which State is "Fairer"?

a. Tax Table Comparison

MD Tax Brackets		NY Tax Brackets	
0–$1,000	2.00%	0–$16,000	4.00%
1,000–2,000	3.00%	16,000–22,000	4.50%
2,000–3,000	4.00%	22,000–26,000	5.25%
3,000–200,000	4.75%	26,000–40,000	5.90%
200,000–300,000	5.00%	Over 40,000	6.85%
350,000–500,000	5.25%		
Over 500,000	5.50%		

b. Tax Burden Comparison

	NY		MD		Tax Gap to $500,000	
	Tax	Effective Rate	Tax	Effective Rate	NY	MD
$50,000	$823	1.65%	$1,467	2.93%	4.05%	3.83%
75,000	2,325	3.10%	3,302	4.40%	2.60%	2.36%
100,000	3,812	3.81%	4,874	4.87%	1.89%	1.89%
150,000	7,636	5.09%	7,750	5.17%	0.61%	1.60%
500,000	28,489	5.70%	33,824	6.76%	-	-

In contrast to the New York code, whose permanent code features five brackets ranging from 4 percent to 6.85 percent,[106] the Maryland state income tax code as of 2008 included seven tax brackets ranging from 2 percent to 5.5 percent, plus local add-on rates that varied by county.[107] It was thus among the states Governor Cuomo described as having "larger ranges [between minimum and maximum rates] that reflect a fairer distribution of the tax burden."[108]

However, as shown in Table 1, Maryland imposed higher taxes on couples earning $100,000 and less than New York did under its permanent tax code, and the gap between middle-income payers and high-income families was smaller in Maryland.[109] The standard deduction and personal exemptions of the New York code more than offset the surface progressivity of the Maryland

[106] Act of Dec. 9, 2011, ch. 56, 2011 N.Y. Sess. Laws 1521–22 (McKinney) (codified at N.Y. TAX LAW § 601(a)(2) (McKinney 2006 & Supp. 2012)).

[107] *See* MD. CODE ANN., TAX-GEN. § 10-105 (LexisNexis 2010).

[108] Gov. Cuomo Op-Ed on Tax Reform, *supra* note 103.

[109] *See* MINNESOTA TAXPAYERS ASS'N, COMPARISON OF 2008 INDIVIDUAL TAX BURDENS BY STATE 6 (Sept. 2011), *available at* http://www.mntax.org/documents/Income_Tax_Burden_Study_TY2008_FINAL.pdf.

tax rate structure. If fairness is strictly equated with the slope of progressivity, the distribution of the income tax burden was actually "fairer" in New York.

As illustrated in Figure 1, the distribution of the tax burden in New York was quite progressive under the permanent law. Independent analysis supports this view. A detailed 50-state comparison of income tax burdens by the Minnesota Taxpayers Association rated New York's income tax code among the most progressive in the country.[110] A study by the Institute on Taxation and Economic Policy, whose work is frequently cited by those who advocate tax increases on high incomes, classified New York among states having a "very progressive" income tax code.[111]

Arguments such as those made in the Governor's op-ed article were nonetheless repeated in the sponsor's memorandum filed with the personal income tax amendments approved by the legislature on December 9, 2011.[112] The rate changes enacted as part of the package are illustrated in Table 2. As shown, a top rate of 8.82 percent was extended for three more years on taxable incomes above $1 million for single filers and $2 million for married joint filers, while the next-highest rate of 6.85 percent under the permanent law was temporary reduced to between 6.45 percent and 6.65 percent in two new lower brackets.

Table 2

NY's Permanent and Temporary Tax Rates as of 2012

Married Joint Filers

Taxable Income	Permanent Law Rate	Temporary 2009-11 Rate	Temporary 2012-14 Rate*
$40,000–$150,000	6.85%	6.85%	6.45%
$150,000–$300,000	6.85%	6.85%	6.65%
$300,000–$500,000	6.85%	7.85%	6.85%
$500,000–$2 million	6.85%	8.97%	6.85%
Over $2 million	6.85%	8.97%	8.82%

* Top rate to expire 12/31/2014

110 *Id.*

111 INST. ON TAXATION AND ECON. POLICY, WHO PAYS? A DISTRIBUTIONAL ANALYSIS OF THE TAX SYSTEMS IN ALL 50 STATES (2009), *available at* http://www.itepnet.org/whopays.htm. *See* CITIZENS BUDGET COMM'N, NEW YORK: A MODEL OF PROGRESSIVE TAXATION (Jan. 1, 2010, 3:37 PM), *available at* http://www.cbcny.org/cbc-blogs/blogs/new-york-model-progressive-taxation.

112 Sponsor's Memorandum, N.Y. State S., in Support of S. 50002, 2011 Leg., 234th Reg. Sess. (N.Y. 2011), *available at* http://open.nysenate.gov/legislation/bill/s50002-2011; Gov. Cuomo Op-Ed on Tax Reform, *supra* note 103.

Governor Cuomo and legislative leaders pointed out that, compared to the temporary rates due to expire at the end of 2011, the new rates for 2012–14 represented a tax cut for most filers.[113] Compared to the permanent tax law, however, the changes combined a temporary 29 percent tax increase for high-income earners with temporary marginal rate reductions of only three to six percent for most middle-income filers.

The December 2011 law also linked tax rate brackets (except for the highest bracket) and the standard deduction to the consumer price index.[114] The "indexing" of income taxes to inflation became part of the federal income tax code in 1985 but had never previously been considered by New York's legislature. However, like the rate changes, indexing is set to expire at the end of 2014.[115] Any inflation-driven increases in the standard deduction by that point will be permanent, but rates and brackets will return to the permanent law levels in effect as of 2008.

As a fiscal matter, the net result of the changes will be to perpetuate New York's heavy reliance on a small number of households with very high incomes. On the individual level, it will combine large temporary increases for million-dollar earners with token cuts for masses in the middle.[116]

As a result of the December 2011 amendments, New York's statewide income tax at the start of 2012 was eighth highest in the nation.[117] Only two of New York's economic peer states—

[113] Thomas Kaplan, *Albany Tax Deal to Increase Rate for Top Earners*, N.Y. TIMES, Dec. 7, 2011, at A1; *See* Tom Precious, *State Tax Package Still Awaits Final Action*, BUFFALO NEWS, Dec. 8, 2001, at A7.

[114] *Compare* Act of Dec. 9, 2011, ch. 56, 2011 N.Y. Sess. Law 1521, 1521–23, 1526–27 (to be codified at N.Y. TAX LAW §§ 601(a)(1)(B), (b)(1)(B), (c)(1)(B), 601-a(b), 614(f)), *with* News Release, U.S. Dep't of Labor Bureau of Labor Statistics, Consumer Price Index—January 2012 (Feb. 17, 2012), *available at* http://www.bls.gov/news.release/cpi.nr0.htm. *See also* N.Y. State Dep't of Taxation and Fin., Technical Mem. TSB–M–12(3)I, at 3 (Feb. 13, 2012) [hereinafter Technical Mem. TSB–M–12(3)I].

[115] 2011 N.Y. Sess. Law 1521, 1521–23 (to be codified at N.Y. TAX LAW § 601(a)(1)(A), (a)(1)(B), (b)(1)(A) (b)(1)(B), (c)(1)(A), (c)(1)(B)); Technical Mem. TSB–M–12(3)I, *supra* note 114, at 1–2. *See* Leadership Press Release 2011, *supra* note 1.

[116] For a family of four with income of $70,000, roughly the statewide median in 2011, the brackets will cut taxes by $52, reducing the effective rate from 3.1 percent to 3 percent. The individual filer with taxable income of $20,000, highlighted in the governor's example, will save nothing. For a single filer earning twice that amount, the savings from the temporary rate cut comes to $80 out of a total annual income tax bill of $2,343.

[117] *The Facts on New York's Tax Climate*, THE TAX FOUNDATION, http://www.taxfoundation.org/research/topic/46.html (last visited Apr. 1, 2012);

California and New Jersey—imposed higher taxes on the wealthy as of January 1, 2012.[118] New York City residents in the newly established top bracket will pay 12.7 percent, the highest rate in the country.[119]

CONCLUSION

In his 2012 State of the State message, the Governor recounted his justification for the changes he and the legislature had just made to the income tax: "For decades, millions of New Yorkers were burdened with an unfair tax code. Whether a person made $20,000 or $20 million, they paid the same rate. It was just wrong—because a flat tax is not a fair tax."[120]

Ironically, some of those applauding Governor Cuomo's denunciation of the flat tax—including Senate Majority Leader Dean Skelos and Assembly Speaker Sheldon Silver—had been members of the legislature when both houses advanced flat tax plans in 1987. The reform enacted that year aimed to simplify the tax code by reducing the number of brackets and expanding standard deductions and exemptions to achieve a progressive result. Twenty-five years after then-Speaker Miller proposed a flat tax as a way to create "a progressive tax system that hits taxpayers in the proportion of their ability to pay,"[121] the permanent tax code shaped largely by Miller's approach was rejected as "unfair" by a governor of the same political party.

"Fair" or not, if New York's 1987 income tax model (as modified in 1995) has outlived its usefulness, what should replace it?

The legislature will need to consider that question more

State Individual Income Taxes, FED. OF TAX ADMIN. (Jan. 2012), *available at* http://www.taxadmin.org/fta/rate/ind_inc.pdf.

[118] *See State Individual Income Taxes*, *supra* note 117. New Jersey Governor Chris Christie proposed a 10 percent cut in his state's 8.97 percent top income tax rate as part of his 2012–13 budget. *Id.*; Kate Zernike, *Christie Calls for 10% Cut in New Jersey's Income Tax*, N.Y. TIMES, Jan. 18, 2012, at A15.

[119] James Freeman, *Christie to the 1%: Please Occupy New Jersey*, WALL ST. J., Jan. 28, 2012, at A11. New York City's resident income tax has a top rate of 3.876 percent on taxable incomes above $500,000, which is imposed on top of the state income tax. *New York City Tax Rate Schedule*, N.Y. STATE DEP'T OF TAXATION AND FIN. 70 (2011), *available at* http://www.tax.ny.gov/pdf/current_forms/it/nyc_tax_rate_schedule.pdf.

[120] Governor Andrew M. Cuomo, New York State Governor, State of the State Address: Building a *New* New York . . . With You (Jan. 4, 2012), *available at* http://www.governor.ny.gov/assets/documents/Building-a-New-New-York-Book.pdf.

[121] Hughes, *supra* note 65.

seriously within a few years, since the changes of December 2011 all expire at the end of 2014. As part of his December 2011 agreement with the legislature, Governor Cuomo pledged to create a thirteen-member Tax Reform and Fairness Commission, including at least six appointees recommended by the legislature.[122] The Governor and legislative leaders described the scope of the panel as follows:

> The Commission will conduct a comprehensive and objective review of the State's taxation policy, including corporate, sales and personal income taxation and make revenue-neutral policy recommendations to improve the current tax system. In its review, the Commission will consider ways to eliminate tax loopholes, promote administration efficiency and enhance tax collection and enforcement.[123]

To achieve true tax reform, the commission should recognize that, since the enactment of the 1995 Tax Relief Act, New York's permanent income code has become more complex and opaque. The IT-201, New York's income tax long form, now takes up "four pages—twice as many as the federal 1040 [income tax] form."[124] "This doesn't include the extra paperwork needed to claim any of New York's 34 separate income-tax credits," which steadily proliferated in the decade following the 1995 changes.[125]

Governor Cuomo's office, echoing the bill sponsor's memorandum, described the December 2011 changes as "the first major restructuring of the tax code in decades."[126] News media coverage typically described the bill as "sweeping."[127] In reality, aside from temporary rate changes and indexing, the legislature left intact the basic structure of the state tax law. The bill did not represent true tax reform, which would generally entail changes to many more aspects of the code, including those defining taxable income. It was, rather, an expedient short-term response to a combination of fiscal and political pressures, which it effectively, if temporarily, alleviated. The scheduled December 31, 2014, expiration of the tax package makes further tax changes

[122] Leadership Press Release 2011, *supra* note 1, at 2.

[123] *Id.* at 3.

[124] *Compare* N.Y. State Dep't of Taxation and Finance, Form IT-201 Resident Income Tax Return, *available at* http://www.tax.ny.gov/pdf/current_forms/it/it201_fill_in.pdf, *with* Dep't of Treasury, IRS, Form 1040A U.S. Individual Income Tax Return, *available at* http://tax.laws.com/tax-forms.

[125] *See* E.J. McMahon, *Tax-Code Chaos*, N.Y. POST, Apr. 16, 2007.

[126] Leadership Press Release 2011, *supra* note 1, at 1.

[127] Thomas Kaplan, *Cuomo, Praised for Tax Deal, Takes Victory Lap to City*, N.Y. TIMES, Dec. 10, 2011, at A21.

all but inevitable.

Meanwhile, further significant changes also loom on the federal level. After a two-year extension, the Bush tax cuts are due to expire at the end of 2012. No matter who controls the White House and Congress after the next elections, changes to the federal tax code are likely to come well before 2014. These are likely to include further adjustments in the federal tax code's definition of taxable income and deductible expenses, to which New York closely conforms.

From a political and economic policy perspective, opinions about the December 2011 changes to New York's income tax code will naturally differ. But this much is clear: twenty-five years after the last significant tax overhaul in New York, there is once again a need for fundamental tax reform in the Empire State.