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I would like to highlight two particular tax-related proposals in the Executive Budget, before turning to a third important third tax policy concern that has been overlooked in the Executive Budget but deserves your attention.

1. Small Business Tax Cuts

As you know, the budget calls for a further reduction in state taxes for owners and shareholders of farms and small businesses, including limited partnerships. Specifically, effective in 2017 with impacts in fiscal 2018, the budget would expand from 5 to 15 percent the existing exemption of net business income for firms subject to the personal income tax, or PIT. For incorporated small firms, it would reduce the net income tax rate to as low as 4 percent, from the current maximum of 6.5 percent.

Given the eligibility limits—$1.5 million gross income, $250,000 net income—this proposal targets the smallest end of the small business scale. The total savings for taxpayers is estimated at $298 million, mostly via the PIT. That amount may sound large, but spread across more than a million eligible small business participants, the savings per tax filer would be modest—just over a couple of hundred dollars, on average.

On the other hand, I think it's important to note that the proposed tax cut wouldn't even begin to offset the costs many of these same businesses will incur from the governor's proposal, contained in a separate Article 7 budget bill, to boost our statewide minimum wage to $15 an hour.

The added expense of a $15-an-hour minimum wage will easily exceed the *entire* state tax liability of a typical smaller firm with a handful employees earning $10 to $12 an hour— a common starting wage for many occupational classifications, by no means limited to food service. Given the narrow profit margins among many such businesses, the added wage costs will be dozens of times higher than savings generated by the proposed small business tax cut.

Whatever other merits this proposed small business tax cut may have in isolation, it should not be discussed or considered in the same context as the minimum wage increase. Putting aside all other concerns with the issue, there is no imaginable tax cut that would offset or make up for the negative impacts of the $15 minimum wage.

2. The Thruway toll credit

Also classified as a "tax cut" is the governor's proposal for a three-year, $340 million tax credit that would reimburse motorists for up to half of their Thruway tolls, starting with tax refund payments in the spring of 2018.

This proposal is objectionable on several grounds.

To begin with, *if the toll credit is a solution, what exactly is the problem?* After all, tolls on the New York State Thruway are not out of line with those charged by other interstate systems. On a passenger mile basis, Thruway tolls generally are lower than those charged by the state turnpikes in New Jersey, Pennsylvania and Massachusetts. At the same time, the Thruway has significant capital needs that go well beyond the coast of replacing the Tappan Zee Bridge, whose added toll for many years subsidized the rest of the system.

The most objectionable aspect of this proposal is that it represents a completely inappropriate use of a highly unusual one-shot infusion of revenues. There are four and <u>only</u> four fiscally responsible ways to spend this kind of money:

- build up rainy-day reserves;
- invest in programmatic reforms that will fully pay for themselves on a recurring basis once the money is depleted;
- pay down debt; or
- avoid borrowing by paying directly for capital purposes, which has the added benefit of reducing future debt service.

At a time when capital resources are scarce and infrastructure needs are great, the governor is asking you to squander $340 million in a way that will produce absolutely <u>no</u> lasting fiscal benefit. <u>This proposal does not deserve support in any corner of New York, upstate or down</u>. It is an indefensible gimmick, a waste of money that could be far better spent on actual capital purposes.

The money Governor Cuomo wants to devote to toll tax credits should be invested in highway and bridge infrastructure—preferably linked to contractual and tort reforms that can ensure New Yorkers get better value for their capital construction dollars.

3. Unfinished business

Up until two years ago, New York taxed estates valued at more than $1 million—a policy that cast the cloud of a potential death tax over the lifetime savings and assets of hundreds of thousands of families, small business owners and farmers across New York State.

Fortunately, at Governor Cuomo's initiative, the budget you approved for fiscal year 2015 took the very important step of raising New York's estate tax exclusion, so that by 2019 it will match the level taxed by the federal government, which is now nearly $5.5 million. While New York will remain one of a dwindling number of states that still impose <u>any</u> estate tax, the reform was a very big step forward.

Unfortunately, the final legislation also preserves outdated aspects of the old estate tax law, including a steep tax "cliff" starting just above the level of the exclusion. The result, as one leading accountant and estate lawyer noted, is a confiscatory 164 percent marginal New York tax rate on estates valued at between 100 percent and 105 percent of the applicable federal exclusion amount.[1] A family farmer's surviving children could find an extra combine in the barn after dad dies, and end up paying taxes at the same rate as a Rockefeller heir.

To fix this problem, the next budget should further revise the law so that New York's Estate Tax exclusion, like the one at the federal level, features a true tax <u>threshold</u> rather than a vertical cliff. It's difficult to independently arrive at a revenue impact estimate for this proposal. However, since the vast majority of revenues is generated by super-wealthy estates well above the federal threshold, the impact is largely to be manageable in a future budget context.

Conclusion

The biggest loose ends of all are found in New York State's personal income tax code. In December 2011, the Legislature extended a significantly higher tax bracket for taxpayers earning $1 million or more (or above $2 million for joint filers), combined with rate cuts for married filers earning between $40,000 and $300,000, and a long-overdue provision "indexing" brackets to inflation. <u>All of these changes are temporary</u>, set to expire at the end of calendar year 2017, within the four-year financial plan provided with this Executive Budget.

New York's high top income tax rate—among the highest imposed in any major state—is an economic negative because it creates a disincentive to work, save and invest here.[2] You can see the revenue that comes from this; what you don't see is the revenue you lose, now and in the future, by discouraging wealth creation and investment in New York State.

Economic considerations aside, fiscal stability is another substantial reason to begin planning a phase-out of the millionaire tax. About 43 percent of PIT receipts now come from the top one percent of tax filers -- individuals and couples whose incomes start at just under $1 million a year. This means that 27 cents out of every dollar the state collects from all tax sources will be generated by fewer than 100,000 tax filers, many of them business owners or investors.

Over the last five years, New York has not reduced state taxes—rather, it has raised and redistributed the tax burden—from business payers to individuals, from lower- and middle-income households to high-income households. The so-called "millionaire tax," which didn't exist before the recession, will raise nearly $4 billion this year. About three quarters of this amount has been redirected for purposes described as tax cuts, permanent and temporary.

There are clear risks associated with depending so heavily on such a small number of taxpayers. It means that when high-income households have a bad year, the entire state suffers inordinate fiscal stress. It has happened before, and it could happen again soon enough.

For fiscal 2017, the budget projects a 5.3 percent increase in the capital gains income of New York residents—based in part on the assumption that the S&P 500 will grow by 2.2 percent during calendar year 2016. Given the market's slump however, the S&P will need to rebound by at least 6 percent over the next 11 months to hit the budget's target. Of course, that could happen, but there's less reason to be optimistic now than there was a year ago.

In the fourth quarter of 2015, the state Labor Department's Index of Coincident Economic indicators registered its first two-consecutive-month decline since the end of the recession. Subsequent statistical adjustments may change that—as happened in fact, a year ago, but it's nonetheless a yellow flag. Another yellow flag: the New York Federal Reserve reports that, in December, its own Index of Coincident Economic indicators for New York State decreased at an annual rate of 0.4 percent.

Tax policy should reflect economic reality even as it seeks to improve the economic outlook. We need to carefully rebalance the distribution of New York's tax burden with the twin goals of making the state more competitive and protecting against economic shocks, which are inevitable sooner or later.

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[1] Kevin Matz at https://www.linkedin.com/groups/NEW-YORK-BUDGET-BILL-JUST-4471458.S.5855721452124282880?trk=groups%2Finclude%2Fitem_snippet-0-b-ttl

[2] For further discussion of the economic impact of higher income tax rates, please see the testimony at http://www.empirecenter.org/testimony/2009/03/EJMTaxTestimony31209.cfm