



New York City Council
Committee on Finance Hearing
New York City Department of Finance

Testimony of Michael Hyman
First Deputy Commissioner

February 26, 2018

Good afternoon, Chairman Dromm and members of the Committee on Finance. I am Michael Hyman, First Deputy Commissioner at the NYC Department of Finance (DOF) and I am joined today by my colleagues, Zal Kumar, Director of Business Tax Services and Sheelah Feinberg, Director of Intergovernmental Affairs. Also at the table is Francesco Brindisi, Deputy Director from the City's Office of Management and Budget (OMB). Thank you for the opportunity to testify on the local fiscal impact of the recently enacted Federal tax act.

In December, Congress passed and the President signed the Tax Cuts and Jobs Act, which made the most significant changes to the US tax code since the 1980s. The new Federal tax act affects both individual filers and corporations. As others have noted, the new law hurts many states and local municipalities and New York City is no exception.

With its major changes to the Federal corporate tax and estate tax, the new Federal tax act, in particular, benefits businesses and high-income households, which own the largest estates and receive the bulk of income from passive investments, like real estate, stocks and bonds. It's important to note that the corporate tax law changes are permanent, while the personal income tax benefits expire in 2025. The increases in Federal standard deduction amounts and

reductions in the Federal tax rate structure will help some New Yorkers, but the overall average benefit is small. The fact is that many New York City taxpayers receive little or no benefit from the income tax provisions of the Federal tax act.

My testimony will highlight the law's effects on individuals, businesses, and the revenues collected by New York City and State. I will also describe proposed actions at the State level to counter the more harmful flow-through aspects of the law.

DOF and the OMB have prepared an initial fiscal analysis of the impact of the Federal tax act.

First, the law's impact on individuals and families:

Our models, fed by Federal, State, and City data, estimate that about 25 percent of City filers will receive no Federal personal income tax cut, 10 percent will receive an increase, and 37 percent will receive a cut of less than \$20/week.

The new law limits the State and Local Tax (SALT) deduction to \$10,000, eliminates personal exemptions, lowers Federal tax rates (including cutting the rate for the highest income filers and favoring pass-through income over earned income), stretches brackets, increases the standard deduction, restricts or

eliminates certain itemized deductions, expands child and family tax credits, and eliminates the alternative minimum tax for most taxpayers

DOF and OMB predict that the combined impact of the provisions I have cited will increase Federal taxes an average of 8 percent on hundreds of thousands of New York City residents, the majority of whom have income below \$100,000.

A primary reason for this increase is the \$10,000 limit on the SALT deduction. IRS data shows that Manhattan is the top county nationwide in terms of SALT deductions, with an average deduction of almost \$24,000, well above the new limit, and New York ranks second in SALT deductions claimed among all states.

This coupled with other limitations on itemized deductions and an increase in the standard deduction, mean that about 68 percent of current itemizers will no longer do so. Indeed, among those New Yorkers who we predict will see increased Federal liability, almost all currently itemize.

In general, the Federal deductibility of state and local taxes dates back to the beginning of the Federal income tax system and has been a fundamental

component of “fiscal federalism” in the nation’s history. The Federal tax act undermines this important component of public fiscal policy.

In addition to the impact on Federal liability of City residents, we also studied the impact on New York City and New York State liability. Similar to most states and localities, New York’s tax system piggybacks on the Federal system for tax administration reasons. Because our tax calculation starts with Federal taxable income, when the Federal definition is changed, City and State revenue is impacted. Our models found that the combination of Federal tax changes would increase New York City personal income tax revenue for 1.8 million City taxpayers by \$320 million. This group would also pay an additional \$550 million in New York State taxes. These increases are primarily due to the flow-through impact of Federal tax law changes that reduce the New York standard deduction available to single filers. City taxpayers would also see local increases due to their lost ability to itemize on the Federal return. Currently, State law allows taxpayers to itemize only if they do so on their Federal return. The Administration is concerned about these impacts and, as I will discuss, supports measures to protect City residents.

Fewer than 1 percent of NYC taxpayers would see a reduction in City liability from the flow through of Federal provisions; these taxpayers benefit from the more generous treatment of medical expenses (for 2017 and 2018 only) and the repeal of existing limits on itemized deductions (Pease limitation) for certain high-income taxpayers.

The Federal tax act also makes changes to the Federal estate tax. The estate tax exemption is now doubled from \$5.6 million (adjusted annually for inflation) to \$11.2 million, reducing estate tax revenues by approximately 40 percent. We estimate that the reduction in the amount of Federal estate tax paid annually by wealthier New York City taxpayers will total approximately \$400 million.

Now, let's look at how the law will affect businesses based or operating in New York.

The Federal tax act changes many aspects of business taxes including lowering the corporate tax rate from 35 to 21 percent, lowering the tax rate on pass-through income (taxed at the individual level), establishing a new system for the tax treatment of multinational corporations, modifying net operating loss treatment, and repealing the corporate alternative minimum tax. DOF and OMB

have evaluated each provision to determine whether it will impact the City's business income tax revenue. As with the individual income tax, only changes to taxable income can flow through to the City; Federal rate and credit changes will not directly impact our corporate tax revenue.

While we are still determining the revenue impact on City business income taxes, we have identified several highly significant provisions. The deemed repatriation income provision in the Federal tax act will require corporations to report additional income at the Federal level, but this income is generally not included in New York's tax base. However, certain deductions related to that income may be included, resulting in a potential revenue loss. In contrast, certain interest expenses related to repatriated income may be allocated in such a way as to reduce the expenses against business income, thereby increasing our tax base and revenue. There are also a host of less significant provisions which may flow through, some of which may increase, and some of which may reduce, business income tax revenue. The analysis is complicated by the fact that the City imposes entity level taxes on flow-through businesses, such as S corporations and partnerships, while the Federal government taxes all flow-through income only at the individual level.

We will further explore this impact on the City's business income taxes, and are committed to closing loopholes that create a risk of revenue loss.

Now, let's look at the effect of the tax cut and the President's proposed FFY19 budget on City residents and the New York City budget.

The Federal tax act also has a direct and negative effect on the City budget. For example, the act eliminated Tax Exempt Advance Refunding bonds, which may cost us up to \$425 million in savings over the next four years, and increase the cost of repairing roads, bridges, and other critical infrastructure.

Indirectly, lowering the corporate tax rate to 21 percent devalues low-income housing tax credits, which could impact our affordable housing plan by some \$200 million annually.

New Yorkers will be directly harmed as well.

The tax bill repealed the Affordable Care Act (ACA) individual mandate, a key component of the ACA which helps keep health insurance coverage available and affordable for 4.2 million New Yorkers.

This tax bill is projected to cause large federal budget deficits. As a response we can expect to see proposals that cut the federal budget to close the deficit.

Just this month President Trump released his proposed FFY 19 budget, which cuts hundreds of millions of dollars from programs that help some of the most vulnerable New Yorkers, including:

- Drastic cuts to Medicaid, a program that cares for 3.5 million New Yorkers
- The Supplemental Nutrition Assistance Program (SNAP) that helps 1.64 million low-income New Yorkers
- Education assistance that supports Universal Pre-K and other programs
- Community Development Block Grants – which are designed to help low and moderate income New Yorkers
- The Public Housing Capital fund, which NYCHA uses to modernize its developments, and Section 8 vouchers, which support low-income New Yorkers in public housing.

We are working with our partners in Washington to fight cuts to services which benefit some of our most vulnerable residents.

Now, let's look at the State's response.

On February 15, the Governor released his 30-day amendments to help address some of the concerns for personal income tax filers and for New York State's economy. The 30-day amendments introduced proposals to prevent certain provisions of the Federal tax act from flowing through to New York's tax system, including:

- Allow residents to itemize on New York returns whether or not they itemize on Federal returns
- Continue the calculation of New York deductions as before the Federal tax act
- Restore the New York single filer standard deduction.

The personal income tax provisions also affect the City's personal income tax and the City supports preventing the flow through of Federal personal income tax provisions that would increase the personal income taxes of New York City residents.

In the 30-day amendments, the Governor also included a New York payroll tax proposal and a proposal to expand the ability of New Yorkers to make charitable contributions. As is well known, both of these proposals are intended

to mitigate the impact of the severe restriction of the Federal SALT deduction already highlighted in my testimony.

We do not have any comments on the proposals at this time, as they are very complex and require much more analysis of both tax and non-tax related issues.

We are committed to exploring these options with the State to provide relief to taxpayers and also to ensure that there are no unintended consequences for the City's tax base.

In closing, New York City has historically contributed more to the Federal government than it has received. According to the State Comptroller, for Federal Fiscal Year 2016, New York State provided \$40.9 billion more in taxes to the Federal government than it received back. For every dollar in Federal taxes New York State sends to Washington, New York State gets back \$0.84 cents. We are concerned the SALT deduction limitation could worsen the gap.

Thank you for the opportunity to testify today. I am happy to take any questions the Committee may have.



**THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER**

TESTIMONY OF NEW YORK CITY
DEPUTY COMPTROLLER FOR BUDGET
PRESTON NIBLACK

THE IMPACT OF THE FEDERAL TAX LAW
ON NEW YORK CITY

February 26, 2018

Good afternoon, Chair Dromm and members of the Finance Committee. I am Preston Niblack, Deputy NYC Comptroller for Budget. I'm testifying today on behalf of Comptroller Scott M. Stringer, on the impacts of the federal Tax Cuts and Jobs Act (TCJA, P.L. 115-97) on New York City. I'm joined by our Director of Revenue Estimation, Steven Giachetti.

The federal Tax Cuts and Jobs Act represents the biggest change in both personal and corporate federal income taxation in a generation – since the Tax Reform Act of 1986. It could not, however, be more different in spirit and effect from that overhaul. The TCJA represents partisan policymaking at its most petty. The ways in which it appears to deliberately target higher-tax jurisdictions such as ours is unprecedented. In the long run, it profoundly undermines our City's ability to continue to provide a robust social safety net by eroding our economic competitiveness and revenues.

There is a tremendous amount one could discuss today, so in the interest of brevity, I'm going to focus on three broad topics:

- The impacts on New York City individual taxpayers;
- The impacts on the City's economy; and
- The interactions between the new tax law and our State and City tax codes.

I'll conclude with a note of caution about the many unknowns and uncertainties raised by such a massive but hasty overhaul of the tax code.

The Comptroller's analysis shows that nearly 475,000, largely middle-class New York City federal taxpayers would face higher tax liabilities under the TCJA. The capping of the state and local tax (SALT) deduction at \$10,000, and the elimination of certain other deductions, is the most common reason. We estimate that roughly half of taxpayers earning between \$100,000 and \$500,000 in income are likely to face higher tax bills.

At the highest end of the income spectrum (above \$1 million, in our analysis), the picture is more complex, and depends on various factors including source of income. New York City has an unusually large proportion of high-income taxpayers whose income is largely derived from wages and bonuses, as opposed to business income, which, as you know, is treated more favorably under the law. The cap on the SALT deduction obviously tends to raise their tax bills. Perhaps surprisingly, nearly 58% of such taxpayers could actually see increases.

Those millionaires who will get tax cuts get big ones – \$337,000 on average, according to our analysis. They are primarily filers with pass-through business income, which is eligible for a 20% deduction, up to a cap, against a filer's personal

income taxes. Mere wage earners of course won't get this deduction, and will thus be taxed at a higher rate on the same income, violating a basic tenet of tax equity.

In addition to these distributional impacts, the tax bill raises a number of concerns for the long-term economic competitiveness for high-tax jurisdictions like New York.

First, because of the cap on SALT deductions, the difference in top marginal tax rates between high-tax and low-tax states has widened. The ability to deduct state and local taxes on your federal return prior to this year meant that your effective state and local tax rate was lower than your nominal rate. That is now no longer the case, with state and local tax rates effectively a third higher than they were.

The focus on this issue has often been on the very rich (i.e., those with incomes over \$1 million), perhaps for the obvious reasons that they both account for a disproportionate share of taxes paid, and because they are perceived as more easily able to change their tax domicile than middle-class working households.

But it is not just a matter of departing millionaires. As I've noted, this also impacts plenty of middle-class filers. Being able to attract and retain the middle class is important to the City's long-run economic and fiscal health, as well as our social fabric. The federal tax law undermines our ability to do so.

Additionally, the loss of SALT deductibility also means that many more taxpayers will likely choose the expanded standard deduction, rather than itemizing, which also has implications for charitable giving, for example. Many middle-income households may be affected by this, and while they are no doubt most often motivated by other concerns than just reducing their income tax liability, it nonetheless eliminates an incentive for charitable giving that could potentially impact the fundraising of many non-profit social service agencies and other organizations, which are of course a critical part of our City's social services network.

Even the treatment of pass-through business income disfavors New York, because not all business income is treated the same. While the bill provides benefits to real estate partnerships, many professional services partnerships that are an important part of our economy, like accountants, lawyers, and doctors, won't be eligible for this deduction.

The changes in federal tax law of course also impact State and City income taxes, which take federal adjusted gross income and federal deductions as their starting points. This raises the question of "decoupling" – that is, should we adjust our own tax codes so that we are not as closely and automatically tied to the federal code?

Comptroller Stringer testified about the need to decouple at the Local Government hearing in Albany last month. Our analysis indicates that the combined impact on State and City personal income tax liabilities for New York City residents would be almost \$800 million without decoupling.

Governor Cuomo included legislative proposals to mitigate the impacts of the federal tax bill in his 30-day budget amendments. These included an optional payroll tax, charitable contributions for certain public functions, and decoupling certain aspects of the State personal income tax from the new federal law. Notably, the Governor included the decoupling of State and local tax deductions from the federal cap, and eliminating the requirement to use the standard deduction on the State return if you do so on your federal return. The Governor has also proposed amending State law to remove a provision that would have lowered the standard State deduction for single filers – which would cost single taxpayers \$840 million on their State and City returns unless fixed.

The legislature will need to make similar changes at the City level as well, which the Mayor's Preliminary Budget assumed will happen. Without these changes, City taxpayers will face an increased tax bill of some \$365 million, by our estimate.

I will conclude with some observations on corporate tax changes, and on the tremendous uncertainties such a huge change in the tax code raises for the future.

On the corporate side, there are a very large number of unresolved implementation and legal issues and unknowns. The changes to corporate taxes and the treatment of foreign income are some of the most complex features of the Plan. Implementation issues are typical of any tax reform, but are compounded by the fact this Act was passed hastily, in a matter of months, rather than the years it took to pass the 1986 reform. Technical guidance from the IRS and even amendments to the law will be needed on many provisions of the Act.

One thing that seems clear, however, is that, in the short run at least, many companies are using their corporate tax savings for one-time bonuses, stock buybacks, and shareholder dividend payouts, rather than on raising base pay for their workers – whose wages have been stagnant during most of the current economic expansion – or making capital investments. This was an entirely predictable outcome of enacting tax cuts at a time when corporations are sitting on hundreds of billions of dollars in cash, without passing any of it along to workers in the form of higher pay.

Finally, we still don't know how many or what kinds of behavioral responses could be triggered by the TCJA, and how these play out could have a large impact on City tax revenues.

To take just two examples: It remains unclear how the impact of repatriated profits will affect capital gains realizations and dividends. And the differential in tax rates between pass-through entities and C-corps could cause some existing partnerships to restructure as C corps. In NYC, this could be even more pronounced, given the double taxation of pass-through income at both the entity level and that of the individual taxpayer. There are reports of such restructurings already. Due to the lower corporate rate, such restructurings could ultimately result in lower revenues at all levels of government, including New York City because of its unincorporated business tax.

That was, perhaps, the intent all along. Because the worsening of the federal deficit as a result of the tax bill is not sustainable in the long run, it is clear that cuts to social services, education, healthcare, and other programs that provide critical services to many New Yorkers are next up on the agenda in Washington.

In sum, while we do know many of the impacts of the TCJA with a good degree of certainty, for all the reasons outlined above we will not know the full extent for many years to come. But there are already many reasons to be concerned about how the tax bill will ultimately affect our economy, our revenues, and our residents.

Thank you, and we are happy to take your questions.



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Testimony of George Sweeting
Deputy Director, New York City Independent Budget Office
To the New York City Council Finance Committee
Oversight Hearing on the Effects of Recent Federal Tax Law Changes

February 26, 2018

Good afternoon Chairman Dromm and members of the committee. I am George Sweeting, deputy director of the Independent Budget Office. Thank you for the opportunity to appear before you today as you consider the effects of the recently enacted Tax Cuts and Jobs Act (TCJA) on taxpayers in New York City.

The act will affect most New York City taxpayers in diverse ways, some positive and some negative. It also brings significant economic and fiscal risks for New York City and New York State. Some of these problems are readily addressed by straight-forward changes to the personal and business income tax laws of the city and state. Others could require more significant changes to our tax system that would benefit from careful vetting and analysis before proceeding, particularly because many of the taxpayers who are negatively affected are benefitting from other provisions in the act.

The single largest federal tax cut in the act accrues to businesses thanks to the sharp reduction in the federal rate from 35 percent to 21 percent. That change has no direct effect on state and local business taxes, but other changes will, particularly the treatment of foreign income earned by U.S. businesses. The Governor's 30-day amendments to the Executive Budget legislation addresses one consequence of the business tax changes: the deduction for repatriated foreign dividends for state tax purposes. The city may also need to address business tax changes at the city level.

On the personal income tax side, the most important changes to the federal tax code are:

- nearly doubling the standard deduction
- removing the personal exemption while expanding the child credit
- capping the state and local tax deduction and lowering the cap on the mortgage interest deduction
- introducing a 20 percent deduction on income from some types of pass-through businesses
- modest reductions in tax rates
- raising the thresholds for the alternative minimum tax.

The deduction changes have understandably drawn the most attention. The Governor's 30-day amendments propose changes to the state and city standard deductions in order to sidestep what would otherwise have been large state and city tax increases for many taxpayers. Enacting these changes means forgoing tax windfalls for the city and state budgets and it seems likely that they will become law.

Deductibility of state and local taxes, or SALT, has been part of the structure of the federal income tax since its inception over 100 years ago, based on the premise that the income should not be taxed twice. However, the deduction also has the effect of shifting the federal tax burden from states with high taxes, which tend to have taxpayers with higher incomes, to states with lower taxes, which tend to have taxpayers with lower incomes. Although regressive, SALT deductibility is deeply embedded in our country's structure of fiscal federalism and is not easily altered without compensating adjustments elsewhere. Unfortunately, the TCJA offers little evidence of concern for the many states and localities that will be profoundly affected by this shift.

Capping SALT deductions at \$10,000 poses long-term threats to the city and state economies and will have immediate consequences for many city taxpayers. But the number of taxpayers affected may be less than frequently discussed. Virtually all city taxpayers with adjusted gross income (AGI) below about \$75,000, who account for two-thirds of all city taxpayers and one-half of city taxpayers claiming SALT, will get a tax cut—at least until 2026—thanks to the larger standard deduction and lower rates. For those with AGI between \$75,000 and about \$125,000, average SALT deductions were about \$12,000. Most of these taxpayers, too, will come out ahead thanks to the larger standard deduction and lower rates.

Among taxpayers with AGI between \$125,000 and about \$500,000 the story is somewhat different. Many, if not most, had already lost their SALT deduction because they were subject to the federal alternative minimum tax (AMT). Thus, there is no change due to TCJA. But because the burden of the AMT falls for households with AGI above \$500,000, it is primarily these 56,000 taxpayers who will be most affected by the loss of SALT deductibility; although they are only 2.6 percent of all city taxpayers, they account for 53 percent of city income tax revenue. While this change will increase their federal taxes, other changes in the TCJA such as the 20 percent deduction for pass-through income, the corporate rate reduction, and higher thresholds for the AMT, all of which disproportionately benefit households in this income range, should result in offsetting some or all of the loss of the SALT deduction. Our office is working to develop a more comprehensive estimate of the changes facing these taxpayers.

The Governor's 30-day amendments include two proposals for limiting the effect of the SALT change for the federal tax liability of New York residents. One would create trusts to receive donations from state and local taxpayers of payments for various public purposes. Taxpayers would then receive a new state tax credit equal to 85 percent of the donations made to such trusts. Because charitable contributions remain deductible for federal tax purposes, taxpayers would regain much of the benefit they had previously received through the SALT deduction. It remains to be seen whether the Internal Revenue Service would be willing to treat such donations as legitimate charitable donations. The second proposal by the Governor would create a new optional employer payroll tax in the state. The tax would be 5 percent on wages of employees who earn over \$40,000. The employees would then receive a credit for the tax paid by their employers to be used against their state personal income tax. Because payroll taxes remain deductible for federal business taxes, employers would be held harmless. There are several potential complications that could undermine how well such a system works, not to mention the question of whether the federal government would allow it to stand.

Let me conclude with some observations about the broader effects of these changes. First, while most economic forecasters have raised their forecasts for economic growth somewhat for the next few quarters, few outside the Trump Administration are projecting a major long-term boost to growth

attributable to the act. With the economy near full employment there is little reason to expect that the tax cuts can stimulate much new growth, particularly with the tax cuts tilted toward high-income households who have a greater propensity to save than households with lower incomes. And despite headlines about firms paying bonuses and hiking wages, more careful analysis suggests that so far more of the tax savings are going into stock buybacks and dividends.

Second, although the act has officially cost the federal government \$1.5 billion over 10 years, the true cost is more likely to be \$2.5 billion assuming the personal income tax changes are not allowed to expire as scheduled after 2026. Most of this cost will be borrowed, thereby adding to the national debt and prompting alarmed calls from Congressional leaders about the need to cut spending. Proposed targets include Medicaid, food stamps, and other safety net programs that primarily benefit lower income households—the households that receive the smallest benefits under the TCJA. The nonpartisan Tax Policy Center in Washington has analyzed the distributional effects of some possible spending reduction plans and found that the combined effects of the act and potential spending reductions range from regressive to extremely regressive. If such federal spending reductions are enacted, demands to replace the federal dollars would present very difficult choices for both New York City and State.

Thank you again for the opportunity to testify and I would be happy to answer your questions.



**Testimony of the Partnership for New York City
Kathryn Wylde, President & CEO**

**New York City Council
Committee on Finance**

**Impact of the Federal Tax Law on New York City
February 26, 2018**

Thank you Chair Dromm and members of the committee for the opportunity to testify about the impact of recent federal tax changes on New York City. The Partnership for New York City represents the city's business leaders and largest private sector employers. We work together with government, labor and the nonprofit sector to promote economic growth and job creation in New York.

As the nation's business and real estate capital, New York City can expect to benefit from federal tax reform, particularly the reduction of corporate tax rates and of taxes on repatriation of profits from overseas operations. Many corporations have already announced plans to dedicate a portion of tax savings to salary increases for lower wage employees, additional employee bonuses and expanded investment in the U.S. But not all businesses are realizing equal benefits. For example, partnerships like legal and accounting firms and boutique investment banks and venture capital firms – all major employers in the city – are not getting the tax advantages of so-called pass-through entities under the new law. And many implications of the law are still not fully understood.

The biggest negative impact for the city is the loss of state and local tax deductibility for individual taxpayers, specifically capping those deductions at \$10,000. As a result, residents of New York and nine other states with high property and personal income taxes will not see the same tax reductions as tax filers in lower tax states. On the contrary, some highly compensated New York employees – think Wall Street, corporate executives, tech entrepreneurs, entertainers, hospital administrators and doctors – will see a tax increase.

Contrary to some political rhetoric, the Trump tax reform is probably going to benefit most low- and middle-income workers, although not as much here in New York as in other states. Our partnership analysis shows that the typical New York single taxpayer earning more than \$500,000 and married taxpayer earning more than \$750,000 will have a bigger tax obligation because of the inability to deduct state and local income and property taxes.

There are about 60,000 tax filers who earn over \$1 million in the state, most of whom will be paying between 52 and 57 percent of their marginal income to the government, with the highest tax burden falling on residents of New York City and its suburbs.

The taxpayers our city and state rely on for most of their revenues are severely impacted. The top one percent of tax filers—city residents who earn more than \$700,000—account for 49 percent of all city income tax revenues and also generate significant economic activity through their spending power. These are 37,200 households out of 3.7 million total income tax filers.

There is also a competitiveness issue. New York residents whose taxes are not actually increasing under the new law—due to lower rates, the child tax credit, and higher standard deduction—will still fare worse than residents of most other states. An average family of four earning \$175,000 will pay 25 percent of their income in taxes in New York, but only 14 percent if they reside in Florida. For the family earning \$750,000, 40 percent of their income will be spent on taxes in New York versus 30 percent in Florida.

So the federal tax law will help our businesses compete in global markets, but it will make it more difficult and more expensive for them to recruit and retain top talent. Employers in key industries are calculating how to respond to this challenge—should they increase compensation to offset the tax burden, or should they relocate jobs to London, Asia, or lower-taxed American cities? In short, New York will be the global commercial center with the highest income tax rates in the world on its top earners. This will make it more expensive for employers to attract talent to the city and for entrepreneurs to build businesses here.

It is important that leaders in city and state government demonstrate their understanding of these issues. Governor Cuomo has included measures in his executive budget that attempt to offer some relief to those who will be most impacted by personal income tax increases. This is the right message to send to employers and taxpayers. On the other hand, proposals coming out of some quarters for another millionaire's tax or other tax increases on high earners put the city and state in jeopardy of significant revenue and job losses. Anyone who thinks migration of jobs and high earners out of the city isn't happening should speak to the realtors in Florida.

Elected officials around the country and world have quickly understood the competitive opportunity for poaching jobs and talent from New York. We urge the City Council and other elected officials to help fend off these efforts, first by acknowledging that we have a problem and second by looking at the current structure of the UBT and other tax laws and regulations to ensure that the city is taking whatever measures it can to mitigate the negative impact of the federal law on individuals and certain pass-through entities. We do not project that this tax law is a net negative for New York's economy, unless we fail to deal honestly with its implications. We appreciate this Council hearing as an illustration of the kind of fact-finding and policy review that is necessary to keep New York competitive.

What the Tax Plan Means for New Yorkers

Increases the tax disparity between New York and other states

In New York City:

The average family of four that earns \$175,000 will pay 25% of their income in taxes; in Florida the same family will pay 14%.

The average family of four that earns \$750,000 will pay 40% of their income in taxes; in Florida the same family will pay 30%.

The top 1% of filers, New York City residents earning over \$700,000, account for 49% of all income tax revenues in New York City.

Tax Decrease/Tax Increase in 2018

Income	New York City		New York State excluding New York City		Florida	
	Single	Married	Single	Married	Single	Married
\$50k	-\$1,067	-\$294	-\$1,327	-\$294	-\$1,327	-\$294
\$75k	-\$797	-\$2,244	-\$1,285	-\$2,244	-\$2,217	-\$2,244
\$100k	+\$226	-\$1,406	-\$689	-\$2,265	-\$1,969	-\$2,654
\$150k	-\$605	-\$2,455	-\$1,153	-\$3,770	-\$2,867	-\$6,154
\$175k	-\$3,418	-\$3,706	-\$3,418	-\$3,706	-\$3,645	-\$6,671
\$200k	-\$3,615	-\$5,831	-\$3,615	-\$5,831	-\$4,238	-\$7,778
\$500k	+\$4,944	-\$19,417	+\$4,944	-\$19,417	+\$97	-\$19,743
\$750k	+\$25,993	+\$1,288	+\$14,531	-\$1,741	-\$6,229	-\$22,001
\$1m	+\$26,444	+\$10,132	+\$11,145	-\$5,128	-\$15,292	-\$31,065
\$5m	+\$139,642	+\$114,916	+\$62,947	+\$38,260	-\$102,711	-\$118,483
\$10m	+\$281,903	+\$257,177	+\$128,463	+\$103,777	-\$211,846	-\$227,619

This reflects the loss of deductibility of state and local income, property and sales taxes over \$10,000.

Single Filers Brackets

2018	Current
10%: Less than \$9,526	10% \$0-\$9,325
12%: \$9,526-\$38,700	15% \$9,326-\$37,950
22%: \$38,701-\$82,500	25% \$37,951-\$91,900
24%: \$82,501-\$157,500	28% \$91,901-\$191,650
32%: \$157,501-\$200,000	33% \$191,651-\$416,700
35%: \$200,001-\$500,000	35% \$416,701-\$418,400
37%: \$500,000+	39.6% \$418,401+

Married, Filing Jointly Brackets

2018	Current
10%: Less than \$19,051	10% \$0-\$18,650
12%: \$19,051-\$77,400	15% \$18,651-\$75,900
22%: \$77,401-\$165,000	25% \$75,901-\$153,100
24%: \$165,001-\$315,000	28% \$153,101-\$233,350
32%: \$315,001-\$400,000	33% \$233,351-\$416,700
35%: \$400,001-\$600,000	35% \$416,701-\$470,700
37%: \$600,000+	39.6% \$470,701+

This analysis is based on a single taxpayer with no dependents and a married filing jointly tax filer with two child dependents. It accounts for the new tax brackets, the allowance for up to \$10,000 in SALT deductions, the increased standard deduction, the increased AMT exemption and higher phase-out level, the repeal of the personal exemption, and the expanded child tax credit where applicable. Deductions for real estate tax, mortgage interest, charitable contributions and sales tax were estimated based on statewide averages at each income level. This analysis does not take into account the changes to pass-through income, the estate tax or the mortgage deduction cap for new homes. This analysis does not take into account changes to other miscellaneous deductions, such as medical expenses. The tax burden analysis is based on after-tax income including the impact of city, state and federal income taxes and average property taxes in each geography for the corresponding income level.



CENTER FOR NEW YORK CITY AFFAIRS

Testimony before the Finance Committee of the New York City Council

Impact of the Federal Tax Law on New York City
February 26, 2018

James A. Parrott, PhD
Director of Economic and Fiscal Policies
Center for New York City Affairs at The New School

Good afternoon, Mr. Chairman, and members of the Finance Committee. My name is James Parrott, Director of Economic and Fiscal Policies at the Center for New York City Affairs at The New School. Thank you for the opportunity to testify on the impact of the recently-enacted federal tax law on New York City.

1. Giant set-back for tax fairness

Make no mistake, the Tax Cut and Jobs Act ("tax bill") that was rushed through Congress in the waning days of 2017 was not "tax reform," it was intended to be an unprecedented tax cut geared to benefit the largest corporations and super-rich political donors.

While the tax bill provides some degree of tax cut for many New Yorkers, in looking at the combined effects of all its aspects, it is clear that it provides the overwhelming bulk of tax reduction to the wealthiest 5 percent. Mainly as a result of the limit on the deductibility of state and local taxes, approximately one in eight New Yorkers will pay more federal tax in 2019, with the incidence of that concentrated in the upper middle income range.

Taxpayers in the top five percent have average incomes of nearly \$1 million; on net, their average tax cut will be about \$16,900, 43 times the average \$390 reduction going to those in the bottom 60 percent of the income distribution who have average incomes of \$33,300. See attached Figure 1.

The rich garner most of the benefits of the steep reduction in corporate taxes since they own a very high portion of all corporate stock. The new 20 percent deduction allowed for pass-through business income was falsely advertised as mainly benefiting small businesses when the reality is that 85 percent of the associated tax reduction will flow to the richest 5 percent in New York.¹

This extremely top-heavy tax cut comes in the context of the pronounced income polarization of recent years, and against a back-drop of a regressive overall New York State and local tax structure (see attached Figure 2), and a highly regressive New York City local tax structure (see Figure 3.)

2. Economic impact

There is no clearcut answer to the question, “What is the overall economic impact of the Tax Cut and Jobs Act?” It certainly will increase the federal deficit by over a trillion dollars in its first decade. Normally, that would lift the economic growth rate. And it may in this case, but there are some off-setting factors that have to be kept in mind. Consider three factors: how the Federal Reserve will respond, the extent to which the deficit increase is offset by federal spending cuts, and the fact that the large corporations mainly benefitting from the corporate tax cuts have shown little inclination to boost domestic investments in recent years despite already very-high after-tax profit levels.

A dramatic increase in deficit spending may be warranted when there is a lot of slack in the economy, but the national economic recovery is now in its ninth year, unemployment is fairly low, and the Federal Reserve has already begun to raise interest rates. Recent stock market gyrations were largely due to concern about the effect a much higher federal deficit might have in leading the Federal Reserve to raise interest rates faster than previously anticipated. The cumulative effect of several interest rate increases by the Federal Reserve will be to slow the pace of economic growth, and many times in the past such steps have resulted in a recession. In addition, the President’s recently released budget proposes sharp cuts in many domestic spending areas that would further fray the safety net and retard economic growth and long-needed public investments in infrastructure.

¹ The tax bill also included repeal of the individual health insurance mandate penalty under the Affordable Care Act, widely considered to result in higher premiums in the individual market and fewer people with health insurance. Timothy Jost, *The Tax Bill and the Individual Mandate: What Happened, and What Does It Mean?* [Health Affairs](#) blog, December 20, 2017.

It should be noted that even without additional federal economic stimulus the New York City economy has, in recent years, been experiencing its strongest sustained job growth, low unemployment, and fairly broad-based wage and incomes gains in decades.

3. New York's competitiveness and fiscal federalism

There is no question that, in acting to tightly limit the deductibility of state and local income and property taxes, the authors of the federal tax bill sought to harm states like New York and California that have long and deeply-rooted traditions of caring for the poor, providing expansive public services and better health care access. Limiting state and local deductibility goes against the century-old tenet of *fiscal federalism* that dates to the early days of the federal income tax. Most public services and infrastructure investments are provided in this country by state and local governments—this tax bill comes down squarely on the side of a heavy-handed federal government discouraging states and localities from serving the needs of its citizens and making needed investments in our economic infrastructure. Governor Cuomo's office estimates that the new federal limits on the deductibility of state and local taxes will cost middle and upper income New Yorkers who itemize deductions an estimated \$14 billion.²

We should be concerned about the possible effect of the limit on state and local deductibility on the State and the City if it leads high-income households to pull up stakes for lower-tax jurisdictions. However, we should keep in mind that the combined City and State tax burden has been higher than in many areas for several years, and still the net number of high income households in New York City has risen steadily in recent years. The best available research on the question of millionaire migration and taxation finds that the rich are generally so tied to local economic and social networks that they have largely not moved out of states that have imposed higher income taxes.³

4. Impact on New York City taxes

Assuming the state legislature enacts measures proposed by the Governor to decouple the New York State tax code from the federal tax code, the federal tax bill may not have much of a direct impact on New York City tax collections (assuming there aren't significant macroeconomic effects.) The Governor has proposed to retain (without limit) the state

² New York State Division of the Budget, Summary of Proposed Tax Reforms, FY 2019 Executive Budget 30-day Amendments, February 2018, p. 1.

³ Cristobal Young, Charles Varner, Ithai Z. Lurie, and Richard Prisinzano, *Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data*, American Sociological Review, 2016, pp. 421-446.

deductibility of local property taxes, to eliminate the requirement that taxpayers may only itemize deductions on their New York return if they itemize on their federal return, to decouple from the federal tax bill's increase in the medical expense deduction and decreases in other itemized deductions, and a change to allow single-filers to claim the standard deduction in the wake of the elimination of the personal exemption on federal returns.⁴ Since New York City uses the New York State tax form for itemizing deductions, the proposed changes regarding itemized deductions to the state income tax will apply to the city income tax as well.

Generally, the City and the State will have to monitor how the new federal tax bill is implemented and interpreted, and make further adjustments as needed to prevent harm to the City's and the State's tax base. One area where this is a particular concern is how the reduced federal corporate tax on the repatriation of corporate profits held overseas is implemented.

5. Potential impact on federal aid received by the City budget and city residents

New York City and New York State budgets are heavily dependent on Federal aid, particularly in areas like health care, education, housing and human services. Well over one-third of the state budget is federal aid, and while only 10 percent of the City budget comes from federal aid, both the NYCHA and Health + Hospitals budgets receive half or more of their funding from the federal government, and the City budget backs up both of these budgets. To take just one example, 43 percent of the budget of the Administration for Children's Services comes from federal aid.

There is a real risk that the increase to the federal deficit resulting from the federal tax bill could be used to justify steep cuts in many areas of federal aid critical to the City budget and the people of New York City. To take just two of many examples, rental housing assistance and food stamps are both targeted for sharp cuts in the President's recently released federal budget proposal. The President's new budget calls for a 42 percent inflation-adjusted cut in non-defense discretionary spending over the next decade that would take it to its lowest level as a percent of gross domestic product since Herbert Hoover was President.

To the extent there are harmful federal budget cuts affecting New Yorkers, the state and the city should consider a targeted federal tax cut windfall recapture tax to provide additional state and city revenues to offset some of the federal cuts.

⁴ New York State Division of the Budget, Summary of Proposed Tax Reforms, FY 2019 Executive Budget 30-day Amendments, February 2018, p. 4-5.

6. Tax workarounds might be unworkable

In his 30-day amendments, Governor Cuomo has proposed two workarounds to offset some of the higher federal taxes that New Yorkers would pay under the Federal tax bill. One of these is an “employer compensation expense tax” that would function like a state payroll tax that would go to the state on behalf of an employee with wages over \$40,000 a year and lessen by a like amount the state income tax owed by that employee. Such a tax would lessen the employee’s federal tax liability. Employers would have the choice to opt in. While I am sympathetic to the motivation behind such a mechanism, I think such a tax would be difficult to implement fairly and efficiently, and would be disruptive of normal compensation practices and collective bargaining agreements. If it chose to do so, the City could opt to create a similar mechanism for city taxpayers.

Another of the Governor’s proposals is to set up two new funds benefiting state education and health care services that would receive charitable contributions from New York taxpayers, and for which contributing taxpayers would receive a federal tax deduction, provided they itemize deductions. The taxpayer would be able to claim those contributions as deductions on their federal and state returns and would receive an 85 percent state income tax credit for such charitable contributions. The Governor’s proposed legislation also authorizes school districts and local government units to create charitable funds for education, health care, and other charitable purposes, and allows taxpayers to receive a reduction in local property tax bills equal to 95 percent of the donation.⁵

Both of these approaches are laudable in intent given the punitive nature of the federal tax bill, but I believe both are administratively complicated, subject to legal challenge, and might lessen support to repeal this disastrous federal tax bill. These measures would be geared to those upper middle and high income taxpayers who would owe more federal income tax due to the limit on the federal deductibility of state and local taxes. However, these groups have also already benefitted significantly from state income tax reductions enacted initially in the FYs 2012 and FY 2017 state budgets. Priority in any Albany tax changes should be given to measures to lessen the regressiveness of our state and local taxes.

⁵ Ibid., p. 3.

7. The top NYC tax reform priority is to fix the City's residential property tax

Tax experts across the policy spectrum all agree that various inequities plaguing the City's property tax system urgently cry out for reform. Four ingredients are necessary for true property tax reform. First is a blueprint to correct the problems in current State law. Second, reform should include a "circuit breaker" provision, administered through the local income tax, limiting property taxes in relation to family income. Third, tenants of rent-stabilized units need guarantees that savings will be passed on to them if property taxes decline on rental properties. Finally, unnecessary and hugely costly property tax breaks that have favored the biggest developers and corporate real estate owners (Exhibit A: Hudson Yards) should be curtailed.

The goal should be to reduce disparities in effective property tax rates among residential properties and to lessen the overall regressivity of the City's local taxes directly affecting households. Changes should be phased in gradually—a transition period of 10 to 15 years might be necessary.

Property tax reform has long been considered the third rail of local policy making. There will be winners and losers, and any reform involves a multitude of tradeoffs. This politically challenging balancing act could only be accomplished by a broadly representative group of New York City leaders appointed by the Mayor and the City Council. And, for any group to be willing to take on this challenge, there first needs to be an ironclad commitment from Albany to defer to New York City on local property tax reform and to not seek to impose a different set of priorities.

Thank you for the opportunity to testify today.

#

Figure 1

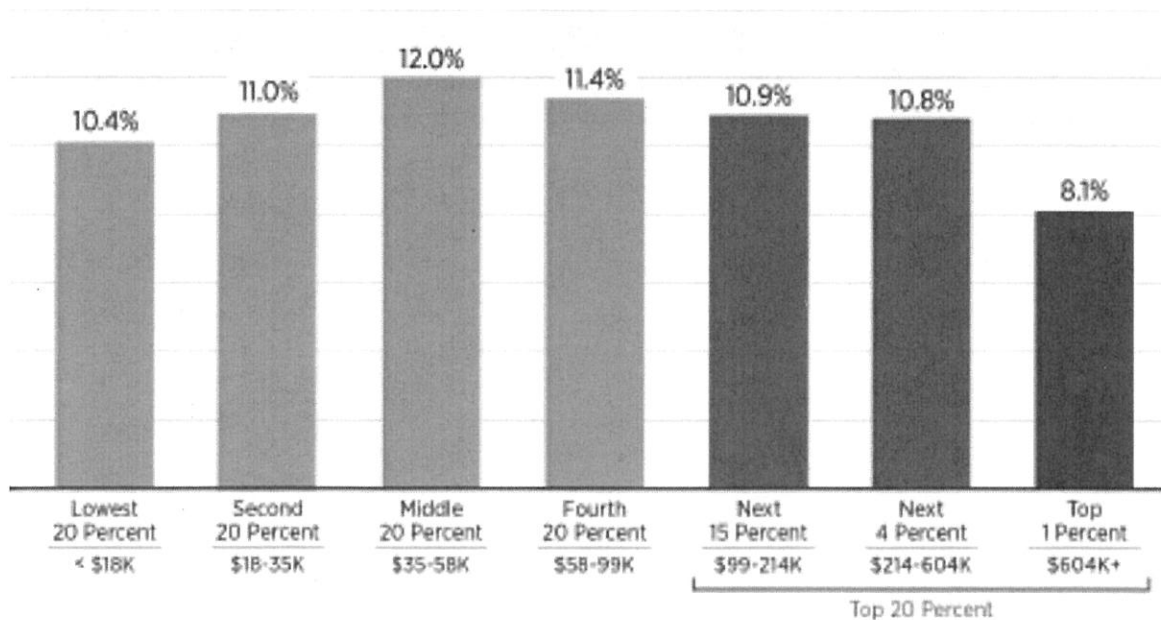
ITEP estimates of combined impact of Tax Cut and Jobs Act, New York State, 2019

New York State tax filers							\$ billions				
		average	share of	share	share	individual	pass-	corporate	estate tax	TOTAL tax	
income range	income	avg. tax	tax	with tax	with tax	income tax	through	tax cuts	cut	change	
		change	change	cut	hike	changes	businesses				
bottom 60%	< \$67,910	\$33,300	-\$390	14%	75%	8%	-\$1.677	\$0.000	-\$0.545	\$0.000	-\$2.280
fourth 20%	\$67,910-\$120,560	\$91,200	-\$1,180	14%	80%	19%	-\$1.551	-\$0.155	-\$0.589	\$0.000	-\$2.276
next 15%	\$120,560-\$280,210	\$172,000	-\$2,150	20%	72%	27%	-\$1.396	-\$0.635	-\$1.080	\$0.000	-\$3.110
top 5%	> \$280,210	\$991,621	-\$16,863	51%	84%	16%	\$3.226	-\$4.953	-\$5.571	\$0.842	-\$8.139
ALL		\$112,300	-\$1,620	100%	76%	13%	-\$1.398	-\$5.861	-\$7.785	\$0.842	-\$15.805

Source: Institute on Taxation and Economic Policy, The Final Trump-GOP Tax Bill: National & 50-State Analysis, Dec. 2017; and detailed NYS table at <https://itep.org/finalgop-trumpbill-ny/>

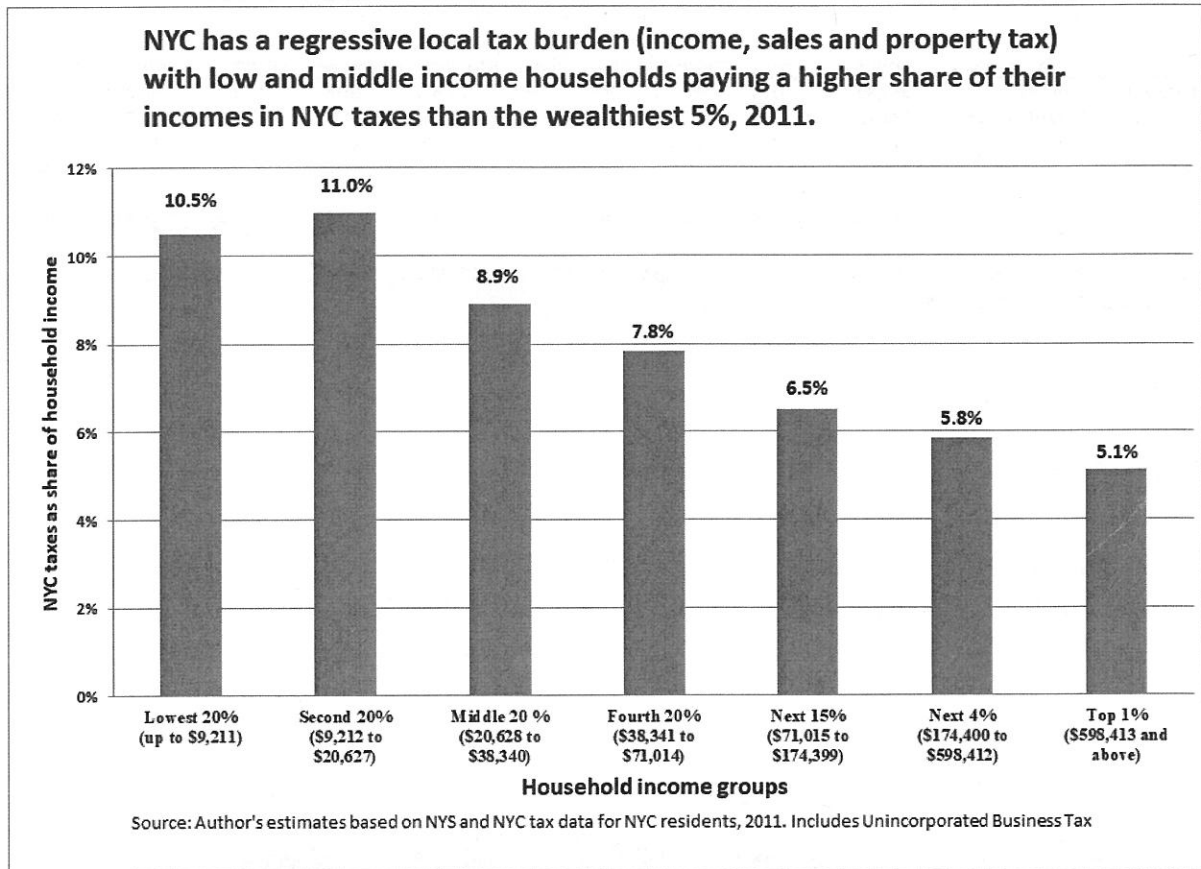
Figure 2

New York State's Regressive State and Local Tax System
PERCENT OF STATE AND LOCAL TAX BURDEN BY INCOME GROUP



Source: Institute on Taxation and Economic Policy, 2015.

Figure 3



Testimony before the NYC council on the 2017 Federal Tax Cuts and Jobs Act
Changes in State and Local Tax Deductibility: Impact on New York City and New York State

Howard Chernick

Professor Emeritus, Hunter College

2/26/18

Thank you for allowing me to testify before the NYC Council on this important topic.

The primary features of the TCJA of 2017 are a sharp reduction in the corporation income tax rate (from 35 percent to 21 percent), on the corporate side, changes in the treatment of income earned by U.S. multinationals, and deductions for pass-through entities.

On the individual side, the tax act increases the standard deduction and reduces tax rates for most income brackets. However, from the point of view of states and cities, the most important change is the limitation in the deductibility of state and local income and property taxes to \$10,000. A second important change is an increase in the exemption level for the Alternative Minimum Tax, and a lower rate of phase out of the AMT.

Why allow the deductibility of state and local taxes under the Federal Income Tax? There is a long legal precedent allowing taxpayers to deduct some or all of state and local taxes. The legal rationale is that state and local taxes on individuals are involuntary payments, that reduce ability to pay. Disallowing deductibility is equivalent to imposing a tax on taxes, and violates the principle of horizontal equity.

State sovereignty under our federalist system is also important. Under the 10th amendment to the U.S. constitution, powers not specifically delegated to the federal government are reserved to the states. However, reserving power to the states, in the absence of fiscal autonomy, is meaningless. The 2017 Tax Act chips away at the fiscal autonomy of states, by raising the cost to residents of financing state and local government.

The economic rationale for deductibility is twofold: first, costs of providing public services differ across states and cities. Cities are more expensive than rural areas, and some regions are more expensive than others. By one estimate, the cost of living is at least 20 percent higher in NYC than in the rest of the country. These higher costs reflect primarily the higher cost of housing in NY than in the rest of the country. Housing costs are higher in NYC and the NY metro area mainly because the cost of land is higher here. Land is more expensive here precisely because there are enormous benefits from locating a wide range of economic activities close together. These benefits – known as economies of agglomeration – result in higher productivity, higher rates of innovation, and greater levels of economic output per worker and per resident. The higher productivity of cities and their metro areas is vividly illustrated by the following map, which shows that half of the output of the U.S. is produced in a small number of cities and their surrounding areas. The nation benefits directly from this greater productivity in terms of higher levels of taxation. In 2015, the average tax paid per return was \$18,677 in NYS,

versus \$14,500 for the U.S. as a whole, or 29 percent greater in New York State. This differential exists even with deductibility of state and local taxes.



The higher cost of living is not directly reflected in federal tax rates.¹ Higher costs of living in large cities are also reflected in the differential costs of public services. To purchase the basic services of government – sewerage and sanitation, police and public safety, clean air and clean water, education, transportation – taxpayers, both firms and households, must pay more than in lower cost areas of the country. Deductibility of state and local taxes is a way of taking account of these regional differences in the cost of public services.

A second reason for higher costs of government in NYC and other cities is that local governments, aided by state assistance, undertake a substantial amount of redistributive activity to provide health care, housing, cash assistance, and other goods and services to low-income families and individuals. For example, a recent post by the NYC and Budget Office reports that in 2017 NYC spent almost \$1 billion to provide shelter to homeless families and adults. Cities are the effectively the providers of last resort for the needy, and nowhere is this more marked than in NYC.

In effect, federal deductibility is helping to subsidize for redistributive activities, many of which are more effectively provided locally than nationally.

¹ There is no feasible way to make precise and politically acceptable adjustment for cost of living differentials under the federal income tax.

On the tax side, deductibility is widely viewed as reducing the progressivity of state and local tax systems (as well as the federal income tax). This is because the probability of itemizing increases with income, as does the marginal tax rate, so that higher income taxpayers are able to offset their state income and property taxes at a higher rate. However, in my own research I found that states with greater rates of itemization tend to offset the direct regressivity effect of deductibility by greater reliance on income taxation, which tends to be more progressive than taxes on consumption.² I found that eliminating the deductibility would lead to a substantial decrease in the progressivity of state and local tax systems. Hence, deductibility increases the degree of redistribution in the federal system. Absent this type of subsidy, state and local tax and benefit systems are more vulnerable to a race to the bottom, where the lowest tax states, and least redistributive fiscal systems come to dominate. School finance equalization, (for example from the NY metro area to upstate NY), which is the major redistributive activity of most state governments, is at grave risk.

Under the guise of federal tax reform, there have been various attempts to limit the deductibility of state and local taxes. Currently, taxpayers can deduct either the income tax or the sales tax, but not both. The evidence shows that this limitation has not had a significant effect on state and local tax structures or levels of taxation. More significantly, the Alternative Minimum Tax, first introduced in 1969, includes state and local taxes as a preference item. This means that for taxpayers subject to the AMT, the value of the deduction for state and local taxes is substantially reduced.³ The impact is much greater in states with high state and local taxes. For the nation, 4.5 percent of filers were subject to the AMT, whereas the rate for NYS was almost double, at 8.5 percent. In 2015, almost all NYS filers with AGI between \$200,000 and \$500,00 itemized their deductions, but 82 percent of this group were subject to the AMT. This means for a large number of filers, the marginal tax price of an additional dollar of state or local income or property taxes was effectively one, i.e. that there was no change in the federal tax bill for a one dollar increase in state or local taxes. Rough simulations show that state and local taxes would have to be reduced from over \$50,000 to roughly \$10,000 for this income bracket to substantially reduce exposure to the AMT.

If one takes account of the role of the AMT in attenuating the effect of deductibility, even though almost half of all filing units in NYS itemized deductions in 2015 (44.3%), rough calculations suggest that the quantitative significance of deductibility (also referred to as the federal offset) was to reduce the marginal tax price of an additional dollar of state taxes by at most 5 cents in 2015, i.e. from one to 0.95. This makes it seem as though the cap on deductibility would not

² Howard Chernick, 2005. "On the Determinants of Sub-National Tax Progressivity in the U.S." National Tax Journal, March 2005. Metcalf, *Journal of Public Policy and Management*, Vol 12, Number 1: Winter, 1993, finds that state income taxation is particularly responsive to the preferences of the highest income taxpayers.

³ Deductibility is further curtailed by the Pease Amendment, which reduces the total amount of itemized deductions by 3% of every dollar of AGI which exceeds \$313,800 (for joint filers).

have a significant effect on the ability of NYS and NYC to raise tax revenues. However, and this is key, **if one weights marginal tax prices, not by the percentage of returns in each AGI class, but by the percentage of AGI in each class**, (which gives much greater weight to filers with AGI greater than \$500,000), the average marginal tax price was roughly equal to 0.74. This means for every dollar of tax paid, the price to NYS taxpayers was only 74 cents. Thus deductibility, even with the growing importance of the AMT, provides a powerful incentive for NYS to have a more progressive tax system, a higher level of taxes, and a more redistributive public sector.

The AMT is substantially revised under and the TCJA, by raising the exemption level, and reducing the phase-out rate for the exemption. The result is that many fewer taxpayers in NYS will be subject to the AMT. (<https://www.kitces.com/blog/final-gop-tax-plan-summary-tcja-2017-individual-tax-brackets-pass-through-strategies/>)

The cap of \$10,000 on the amount of SALT deductions means that the marginal tax price will rise from .74 to 1.0, which represents a **35 percent increase in the ‘price’ of public services in NYS. The effect is undoubtedly even higher in NYC, because of our additional local income tax.**

Does the price effect matter? Some claim that taxpayers do not pay attention to the ‘marginal tax price’, and instead care only about the total amount of taxes they have to pay. Under this view, the immediate effect of the reduction in personal taxes under the TCJA (what economists call the ‘income effect’) will be to allow NYC and NYS to maintain or even increase their levels of taxation. My research suggests that over time the ‘price effect’ matters a great deal. For example, when the next recession comes, as it inevitably will, NY will find it much harder to increase top income tax rates, as it did in 2008, to offset the revenue losses from the recession. In short, income effects matter more in the short run, while price effects matter more in the long run.

The TCJA partially offsets the loss of deductibility by lowering marginal tax rates. For the top income bracket, rates go down from 39.5% to 37%. In principle, these reductions, by lowering the federal tax bill for some taxpayers, could free up tax resources, which could then be tapped by states to offset the potential loss in state tax revenues from the cap on deductibility. The Institute for Taxation and Economic Policy estimates that the average change in taxes for the top 1% of taxpayers in NYS is a reduction of \$30,000. (Available at <https://itep.org/finalgop-trumpbill-ny/>) For the next 4%, the reduction is equal to \$13,600. 56 percent of the top 1% group would face a tax cut, while 43 percent would have a tax increase. However, when ITEP breaks out the components of the tax change, the average individual tax bill for the top 1% would increase by \$62,050. This increase, according to ITEP estimates, is more than offset by a reduction in the rates on pass-through entities and corporations. The large increase on the personal side reflects primarily the cap on deductibility. Since the personal income tax changes are more readily visible and more specific than the business tax reductions, I expect top income

taxpayers to respond more immediately to the personal tax increase than to the delayed increase in income from tax cuts to business.

If federal tax burdens go down, can the state maintain the level of fiscal resources by raising state tax rates on high-income taxpayers. The literature on so-called 'vertical tax competition' is ambiguous on this front. Some researchers (Esteller-Moré Alex, Solé-Ollé Albert. Vertical income tax externalities and fiscal interdependence: evidence from the US. Regional Science and Urban Economics (2001) 31(April): 247-272.) find a positive relationship between federal taxes and state taxes, implying that the reduction in federal rates would lead to a **reduction** in state rates. By contrast, Chernick and Tennant ("Federal-State Tax Interactions in the U.S. and Canada." Publius: The Journal of Federalism, Vol. 40, No. 3, Summer 2010, pp. 508-533.) introduce tax burdens by income class into this question. They find that a reduction in federal tax rates at the top is partially offset by an increase in state rates.

Whether NY state or other high tax states will find the political will to increase top rates after TCJA, or avoid the reduction in top rates which would be encouraged by the capping of deductibility, is unknown at this point. Part of the answer depends on how incomes evolve in the next few years. If economic forces cause the before-tax income of top AGI taxpayers in NYC and NYS to continue to increase more rapidly than average incomes, then the state and city could maintain public services and keep its commitments to the needy by raising income tax rates on the top group (or allow NYC to raise its top income tax rate), without causing undue harm to the local and state economies. California, which is flourishing economically, despite a top rate of 12 percent, is an important example.

The reductions in corporate and individual income tax rates under the TCJA are bought at the price of increasing the federal deficit. The risk of reductions in federal aid to states and cities is substantially increased. In 2014, NYC received ...

Response. As a short-term response to the TCJA, a number of states have explored the idea of providing tax credits for charitable contributions, and using the increased contributions to fund some public services. Bankman et al (Federal Income Tax Treatment of Charitable Contributions Entitling Donor to a State Tax Credit, UCLA School of Law, Law-Econ Research Paper No. 18-02) review the long history of allowing what they call 'full deduction' of charitable contributions which are earmarked for specific types of public services, and find considerable support for such actions. Legislators in Illinois recently introduced a bill that would provide scholarship funds to low-income school children (defined as 400 % or less of the Federal Poverty Line), to be paid for by charitable contributions, which would be eligible for a full offset credit on the Illinois state income tax. This option is made more attractive by the ending of the cap on charitable contributions. Until the TCJA can be repealed or replaced, and balance restored to our system of fiscal federalism, this option should be vigorously pursued by policy makers in NYS and NYC.

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I represent: PUBLIC UTILITY LAW PROTECT OF NY

Address: 90 S. SWAN ST, ALBANY NY 12210

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