FPI responds to the Partnership for New York City:

Can New York Depend on a "Millionaire's Tax" to Solve the Budget Crisis?

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A balanced approach to balancing the New York State budget will do much less harm to the state's economy than a strategy that relies almost entirely on either budget cuts or revenue increases. Excessive reliance on deep spending cuts will worsen New York's already high unemployment and exacerbate the economic adversities bearing down on millions of low- and middle-income New Yorkers. Revenue increases and spending reductions both need to be part of the solution. The challenge for the Governor and the Legislature is to choose those revenue increases and those spending reductions that will together do the least harm to the economy and to the people of the state.

The Partnership for New York City, in its report, "Can New York Depend on a "Millionaire's Tax to Solve the Budget Crisis," seems to be arguing against such a balanced approach to balancing the state budget. In fact, the purpose of the Partnership's report is to argue against one specific option that could make an important contribution to balancing New York's 2011-2012 state budget and an even more important contribution to balancing its 2012-2013 budget. That option involves extending the temporary surcharges enacted in 2009 on single individuals with taxable incomes over $200,000 and married couples with taxable incomes over $300,000.[1]

One of the Partnership's major arguments against extending the surcharge or making it permanent is that the surcharge, by itself, is not sufficient to close the state's budget gap. For example, the report says: "Making the surcharge permanent would reduce a projected $65 billion state deficit over the next four years by only 25%. It does not solve the problem." Governor Cuomo has proposed a multitude of gap closing as part of his plan for balancing the state's budget. Just because none of them would "solve the problem" all by themselves is not a reason to dismiss them out of hand. All the options, on both the revenue and the expenditure sides of the budget, should be considered on the basis of their relative impact on the economy.

The Partnership also argues that extending the surcharge might help in balancing the 2011-2012 but that doing so will leave the state in a precarious situation during the following year or years. For example, the report says: "The surcharge extension would be a palliative to get the state through one budget cycle without taking the actions that are necessary to set the state on a healthy fiscal and economic course for the future." This is a strange argument indeed since extending the surcharge (or making it permanent) would make much more of a contribution to balancing the state's 2012-2013 budget than to balancing its 2011-2012 budget.

Extending the PIT surcharge would add only $1 billion in revenues for the coming state fiscal year, 2011-2012, that begins on April 1, 2011. The surcharge already runs through December 31, 2011. But extending the surcharge for 2012 and 2013 would add at least $5 billion in the state's fiscal year 2012-2013, and would be an important counterweight to the additional cuts in essential services that would be necessary that year if the economic recovery does not accelerate and the states' revenue systems do not rebound.

Even more problematic is what the Partnership's report doesn't say. It completely ignores the hardship that has been inflicted on millions of New Yorkers by the Great Recession that was caused, in large part, by an out-of-control financial sector. While the recession is technically over, the labor market recession affecting the lives of many New Yorkers is likely to persist for at least the next three years.

The tax surcharge is not onerous, and it is offset by federal tax cuts

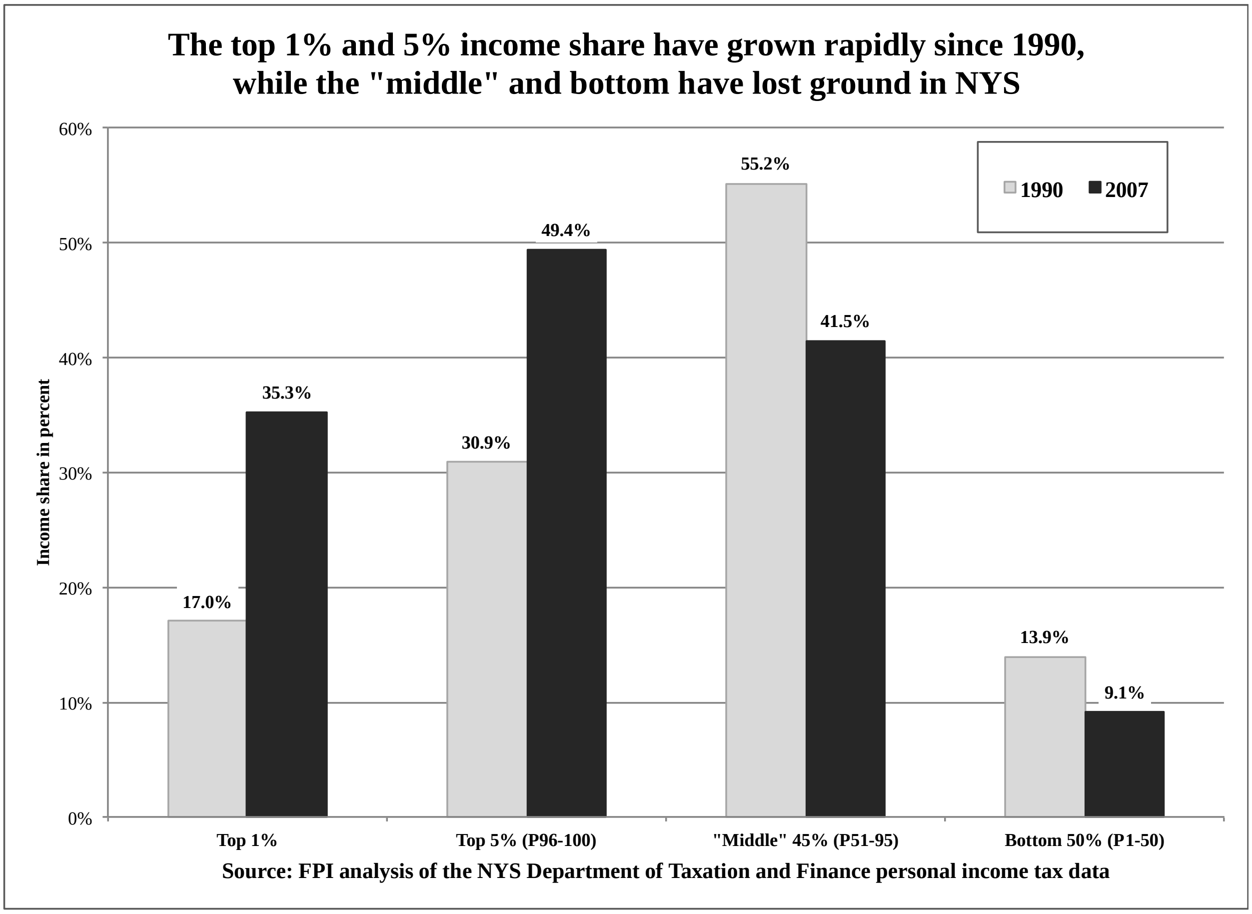
The Partnership's report begins by saying that "In 2009, New York State enacted a temporary personal income tax surcharge on "high earners" ($200,000+). This surcharge increased the top personal income tax rate by 31%." The clear implication of this combination of misleading statements is that the surcharge increases the tax rate by 31 percent for households with incomes as low as $200,000. As indicated earlier in this paper, the surcharge applies to single individuals with taxable incomes over $200,000 and married couples with taxable incomes over $300,000. For a married couple with total income of $350,000 and the average amount of deductions for that income level, the surcharge means a tax increase of 3.3 percent or, stated another way, an additional tax of 2/10ths of one percent of their income. The Partnership's 31 percent figure applies to single individuals and married couples with taxable incomes above $550,000. This 31 percent increase is really a 2.12 percentage point increase from a top rate of 6.85 percent of taxable income to a top rate of 8.97 percent of taxable income. Extending the surcharge will continue these taxpayers' tax rates at their 2009 through 2011 levels. It is worth noting, however, that the taxpayers affected by this tax *increase* have just received a four percentage point *decrease* in their federal income taxes for 2011 and 2012, thanks to the extension of the Bush Administration tax cuts in December 2010 by President Obama and the Congress.

The Partnership reports, without attribution, that in 2009 precisely 219,183 taxpayers "paid an average of over $18,555" due to the surcharge; and again implied that this increase was felt by taxpayers earning between $200,000 and $1 million. But this is a situation in which averages can be very misleading. For a family to owe a surcharge of that amount, its income would have to be over $900,000. The reality of the situation is that an estimated 75 percent[2] of the $4 billion in revenue from the surcharge in 2009 was paid by those with incomes of over $1 million. At the same time, because of the federal tax cuts that were extended in December, this same group will pay on average $34,000 *less* in federal taxes.

The wealthy are increasing their share of the pie, but not paying their fair share of taxes

The Partnership voices a concern that "New York's fiscal condition is dangerously reliant on a relatively small number of high-income earners." The Partnership, however, seems to be more concerned about the high-income earners than about the state's fiscal condition, and its effects on most New Yorkers.

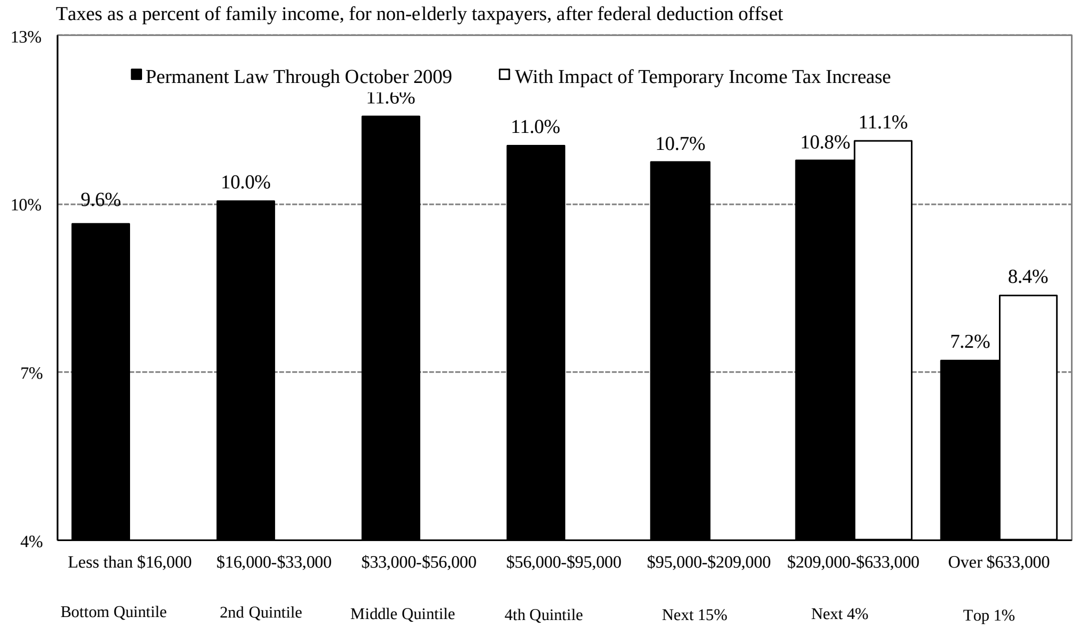
The Partnership points out the increasing share of taxes paid by this group. The report does not mention, however, that the reason the top five percent are paying more in taxes is that they are getting an increasing share of the state's income. In 1990, the top five percent of tax filers in New York State had 30.9 percent of all income; by 2007 the top five percent had just shy of half of all income in the state, 49.4 percent. At the same time, the income share of the bottom half went from 13.9 percent in 1990 to just 9.1 percent in 2007. (See the figure below.)



In addition, it is important to note that *income* taxes are just one part of the state and local taxes. When we include sales, property, and other taxes it is clear that high-income earners are in fact paying a *lower* total tax rate than middle or even low-income New Yorkers. (See the figure on the next page.)

The best way to spread the tax burden more fairly would be to see growth in income for all families, not to see a higher share of taxes paid by people who are struggling to get by.

Overall, the wealthiest 1% of households pay a much smaller share of their income in state and local taxes than do all other New Yorkers, even with the temporary income tax increase.



Source: Institute on Taxation and Economic Policy, 2009. Note: 2007 tax law updated to reflect changes in law enacted through October 2009.

Protecting the state's business climate

It's hard to understand why so many successful businesses would be in New York if it truly has, as the Partnership suggests, the worst business climate of any state in the country.

In fact, the Tax Foundation's state business climate rankings, cited by the Partnership, don't provide meaningful information about states' business climates. Based solely on five statutory tax rates and other selected tax policies, the ranking rewards state with flat rate personal income tax systems while penalizing those with progressive income tax structures.

In Fiscal Year 2011, South Dakota ranked first, followed by Alaska, Wyoming, Nevada, Florida, Montana, New Hampshire, Delaware, Utah, and Indiana. Of these states, eight have no corporate income tax, no personal income tax, no state-level sales tax, or some combination of these policies. Many of the states that rank the highest have economies that are highly dependent on natural resources, allowing these states to rely on mineral extraction taxes in lieu of corporate or personal income taxes.

The Tax Foundation acknowledges that factors such as transportation, a quality educational system, and a skilled workforce affect a state's business climate, but the ranking does not consider these factors, nor does the analysis of tax policies acknowledge how critically these assets rest on a state government's ability to invest in them.

The Partnership also ignores the fact that businesses operating in New York State have the highest productivity per worker, according to the Commerce Department's Bureau of Economic Analysis Gross Domestic Product by State data, among the 10 largest states in the U.S. Profit per worker in New York is also higher than all other large states except for California. State and local taxes pay for, among other things, the high quality public services and infrastructure that support highly dense, urbanized economies.

Small businesses

The fact that some small business owners receive profits as personal income rather than through a taxable corporation is cited by the Partnership as an argument against raising personal income tax rates on the wealthy. According to this line of reasoning, attempting to tax wealthy individuals may inadvertently burden small businesses. However, the reality is that only four to five percent of individuals in New York who are actively involved in operating a business and who report more than half of their adjusted gross income as active business income would be subject to the surcharge. This group includes partners in hedge funds and private equity funds.

It's the economy

New York should continue the personal income tax (PIT) surcharge since unemployment remains very high in New York and is projected to stay above 7 percent until 2014. By any standard, 7 percent unemployment is a recession in the labor market. Budget balancing actions concentrated on the cutting side will worsen unemployment and the adversity experienced by many families in a weak economy. New York needs a balanced approach to balancing the budget, one that looks also at the revenue side, and is not heavily concentrated on the cutting side.

- Unemployment averaged 811,000 in 2010, up 90 percent compared to 2007. A total of 1.3 million are either unemployed, discouraged and have dropped out of the labor force, or are under-employed (working part-time but who want and need full-time work).
- Food stamp rolls statewide have increased by one million, a 60 percent increase, over the past three years.
- One million New Yorkers lost employer-provided health insurance in 2009, five percent of the state's population.
- Medicaid rolls have grown by 18 percent in the last three years, with a 25 percent increase outside of New York City. Four of every ten New York children rely on Medicaid for health coverage.
- New York State's poverty rate increased from 14.2 to 15.8 percent in 2009, the greatest single-year increase in the past 30 years except for 1991. This means that the number of New Yorkers in poverty rose from 2.7 million to over 3 million in 2009.

The Partnership says that "the Downstate New York economy has substantially recovered." However, the official unemployment rate in New York City was 8.9 percent in December 2010, and would have been 9.9 percent (one full percentage point higher) if 40,000 people had not dropped out of the labor force in the last half of 2010. That hardly qualifies as "substantially recovered."

The Fiscal Policy Institute (www.fiscalpolicy.org) is an independent, nonpartisan, nonprofit research and education organization committed to improving policies and practices to better the economic and social conditions of all New Yorkers.

Endnotes

[1] Taxable income is income after adjustments, deductions and exemptions. For example, in 2007, the latest year for which the Department of Taxation & Finance has published its annual analysis of personal income tax returns, taxable income averaged 89 percent of Adjusted Gross Income (AGI) for married couples with AGI of between $200,000 and $500,000.

[2] The share of the surcharge revenue coming from taxpayers with incomes of $1 million or more was estimated using the data presented in Tables 6 and 7 on pages 198 and 199 of the "Economic and Revenue Outlook" volume of the 2011-2012 Executive Budget.