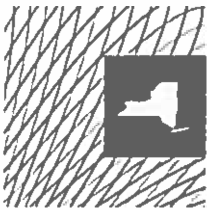

Testimony to

Senate Finance Committee and Assembly Ways and Means Committee

FY 2019 Executive Budget: Taxation Issues

Presented by

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My name is Ken Pokalsky and I am Vice President of The Business Council of New York State, Inc. We are New York's largest statewide employer association, representing 2,400 private sector employers across New York, in all major business sectors.

As always, we appreciate this opportunity to address members of the Senate Finance and Assembly Ways and Means Committee on the Executive Budget.

In our testimony today, I intend to address three major tax policy issues:

- Our overall position on conforming New York's corporate and personal income tax statutes to address recent federal reforms,
- Our input and analysis on the "payroll tax" concepts put forth by the Cuomo Administration, and
- Our response to several of the more significant tax proposals presented in the Executive Budget.

In his state of the state message, the Governor argued that increasing the cost of state and local taxes makes New York less competitive, and helps other states at our expense. We couldn't agree more, and would emphasize that this is true whether the tax increases come from federal or state legislative actions.

It is important to recognize that, despite recent improvements, New York remains a high tax state – New York ranked number one in Forbes' 2016 study of state and local tax burdens; likewise, New York is highest in the most recently-issued Tax Foundation state and local tax burden study. We have the second highest business tax burden in the Tax Foundation's 2018 state business tax burden index, and are ranked only slightly better, ninth highest, in a similar 2017 study by Anderson Economic Group.

This is simply the wrong time to be raising state business taxes, and we oppose a number of proposals in the Executive Budget that would make our tax code less competitive among the states. Importantly, the Executive Budget is projecting a corporate franchise tax revenue increase of more than $1 billion for FY 2019, driven primarily by increased profits. While that forecast may be overly optimistic, it illustrates the importance of economic growth, rather than new taxing mechanisms, to the state's financial future.

Federal Conformance - There is a growing political narrative among pro-tax, pro-spending interests that New York State somehow "deserves" a share of federal tax reform benefits being enjoyed by New York resident and business taxpayers.

Our position is exactly the opposite.

The New York State Legislature should reject proposals to reverse the benefits of federal tax reform, and adopt personal income and corporate franchise tax amendments that eliminate any "windfall" state tax revenues resulting from a misalignment of federal and state tax law.

For example – as highlighted by recent think tank reports, news coverage, and legislative activity -- the failure to make several simple amendments to New York's personal income tax statute in response to federal changes would produce an estimated $1.5 billion increase in individual

taxpayers' aggregate tax liability. One factor is that New York is "coupled" to federal provisions on itemized deductions, meaning that New Yorkers would not be able to deduct more than $10,000 in real property taxes on their state tax returns. New York needs to – and we fully expect the Administration and Legislature will -- "decouple" from these features of federal tax law to avoid undue, even "windfall," tax revenues to the state.

Likewise, there are several significant conformity issues that need to be addressed in the Article 9A corporate franchise tax. Lack of legislative corrections here would result in undue tax liability increases on businesses doing business in New York.

A major purpose of federal corporate tax reform was to bring federal business tax rates in line with other major economies (compared with other OEDC states, federal corporate tax rates were high on both a statutory and effective rate basis), and to adopt a territorial or waters-edge taxing regime comparable to every other major economy.

In the case of multi-national businesses, federal tax reform mostly, but not entirely, ended future U.S. taxation of foreign earnings (a reform that aligns the U.S. tax code with other OEDC states), but in doing so its "deemed" repatriation of previously-earned foreign income subjects these earnings to a one-time federal tax, whether or not such foreign earnings were actually repatriated. New York already has a "waters-edge" corporate franchise tax law, and as result these deemed repatriated foreign earnings will not be taxed at the state level. This is the right approach, as such income has no practical connection to economic activity in New York State, and imposing a state-level tax on these businesses operating in New York will put them at a financial disadvantage compared to other states. We are supporting some technical amendments to Article 9A to assure the maintenance of the state's waters-edge approach.

The Business Council will be advancing several "decoupling" provisions relative to business taxes as well.

For example, under federal tax reform, certain economic development incentives provided by state and local governments will be considered "contributions to capital" and therefore recognized in a business' gross income, adding to their federal tax liability. It would make no sense for New York to remain coupled to that federal change, as it would erode the value of state-awarded capital grants and similar economic development incentives.

Likewise, federal reform provides for "bonus depreciation" -- the ability to write off 100 percent of the cost of capital expenses in the year they are incurred -- but as a trade-off, puts a cap on the deductibility of interest expenses. New York is already decoupled from federal bonus depreciation, and while we support that favorable tax treatment of capital investments at the state level, if New York businesses are not allowed accelerated depreciation, they should not be subject to caps on the deductibility of interest costs related to capital investments.

In the next several days, we will be presenting the Administration and Legislature our complete set of recommendations on business tax conformity issues.

Our basic position is that New York should adopt corporate franchise and personal income tax conformity language that avoids increased state tax liability due to New York's tax law falling out of alignment with new federal language.

At the same time, we oppose measures, including those "justified" by federal tax reductions, that

impose new or increased taxes on New York business and employers. It does not make sense from either a tax policy or an economic competitiveness standpoint to impose this type of tax penalty on businesses because of their presence in New York State. The major benefit from federal tax reform for domestic corporations, doing business here and elsewhere in the U.S., is the reduction of federal corporate tax rates. For New York State to try to capture, through state taxes, some share of these businesses' federal tax reduction will again impair the state's economic competitiveness relative to other states. Even with our 2014 reforms, New York's is a relatively high tax state for business. New York's corporate franchise tax rate of 6.5 percent (applicable to all but manufacturing corporations) is higher than the single fixed rates applied in seventeen other states, including six states with no corporate income or franchise tax. Another eleven states with variable rates have rates below New York's 6.5 percent, so it is fair to say that at best we are in middle of the pack for corporate income taxes. However, businesses pay other taxes, and as mentioned above New York's business tax climate is measured as one of the worst in the nation. Likewise, for pass-through business entities that pay tax on their business earnings through the personal income tax, New York has the eighth highest top marginal rate of any state, and those owners of pass-through entities in New York City are subject to the second highest top marginal rate in the nation.

Payroll Tax and Other Alternatives – We appreciate the Administration's efforts to examine alternative approaches – payroll taxes, charitable contributions – to mitigating the adverse impact of federal tax reform (principally the cap on deduction of state and local taxes, or SALT) on certain New York taxpayers.

Of course, one alternative is to actually reduce the state and local taxes subject to the SALT deduction cap. Expiration of the so-called "millionaires" tax rate and bracket in 2020 will significantly mitigate the impact of the SALT deduction cap for high income earners.

We have reviewed the Department of Taxation and Finance's January 2018 "Preliminary Report on the Federal Tax Cuts and Jobs Act," and have received considerable input from Business Council members. We look forward to reviewing any specific "payroll tax" option that may be included in the 30-day amendments to be issued next week.

Based on what we have seen so far, our members do not support any payroll tax option, for a variety of reasons.

- Any such mechanism will likely result in immediate cost shifts to the employer (as the DTF report recognizes, the payroll tax for PIT can only maintain pre-reform levels of after-tax income for both employers and employees if it is accompanied by a reduction in wages roughly equal to the new payroll tax being paid by the employer – a provision that would be difficult to accomplish in many employment settings.)
- As illustrated in the Executive Budget financial plan, the state will be facing significant budget gaps in each of the next three years, and a new payroll tax on employers will be a tempting target for future administrations and Legislatures looking for increased revenues, but reluctant to impose new or higher taxes directly on individuals. The same can be said of a new entity-level tax on unincorporated businesses, another option explored in the Department's paper.
- Any payroll tax mechanism can only offset a part of the negative impact of the SALT deductibility cap, as upper income taxpayers most significantly impacted by the cap receive

the majority of their income from non-wage sources. Therefore, the benefit from enactment of this major change in state tax policy would be limited.

- Adopting a payroll tax mechanism, especially one that tries to replicate the progressivity of the personal income tax, will impose significant new administrative and compliance burdens on the state and employers.

- Even an "opt-in" alternative, whereby an employer can elect to participate in a payroll tax system, raises concerns. The Department's options paper suggests that employers that opt into such a program could be subject to provisions to "advance other state policy objectives relating, for example, to labor policies and workforce investments." This is a curious suggestion, given that the purpose of this payroll tax approach is to reduce after-tax income losses to employees, not the employer.

At most, we would urge a more thorough review of options with a work group comprised of tax policy and tax administration experts, including those with differing business structures.

We have not taken a position on the concept of a charitable contribution mechanism, with a matching state income tax credit, as an alternative mechanism to fund state and/or local government. In our view, the viability of this approach hinges entirely on whether such mechanisms will be considered as deductible charitable contributions by the IRS.

Executive Budget Proposals – We have detailed, issue-specific legislative memos on a number of tax issues presented in the Executive Budget that we will be sharing with the full Senate and Assembly.

Today, I would like to highlight several tax issues of interest/concern:

- Health care "windfall profit" tax – There is no justification to impose a new state tax on a single business sector, as proposed here, in response to an across-the-board reduction of federal corporate tax rates. Moreover, the health insurance sector in New York already pays the majority of some $5 billion in state-imposed HCRA taxes, in addition to Article 33 premium taxes and DFS-imposed assessments. Ironically, the Executive Budget justifies this new tax by raising concerns about federal cuts in health care aid to New York, and the state's need to pay for vital health care services, however the new revenues would go to the general fund, rather than dedicated health related purposes.

- Tax Credit Deferrals – This administration has focused on economic development initiatives, especially in upstate New York, and on assuring that businesses receiving economic development tax credits meet the job creation and investment targets on which their credits are based. Therefore, we are mystified by this proposal to impose a three-year delay on tax credits earned by businesses that have already kept their commitments to the state. These deferrals will impair the cost/benefit analysis on which these investments were made, and raise uncertainties regarding other state economic development commitments. Moreover, this proposal will have an especially significant impact on the state's manufacturing sector, which benefits from investment tax credits and real property credits, and which will be also experiencing increased energy taxes proposed elsewhere in the Executive Budget. These deferrals will also have a major impact on state efforts to promote the cleanup and redevelopment of brownfield sites and the rehabilitation of historic properties in urban areas. We oppose these deferrals as damaging to the state's economic development efforts.

- "Marketplace provider" tax – This is similar to last year's Executive Budget proposal, and would require web-based platforms to collect sales tax on behalf of third party sellers that have no legal nexus with New York. We appreciate the concerns of the state and "brick and mortar" retailers, but we believe this approach is contrary to the Supreme Court's decision in *Quill*, and will result in an inconsistent patchwork of state-level mandates. Importantly, the Supreme Court has agreed to hear a case this term, *South Dakota v. Wayfair Inc.*, that could establish a new national standard for sales tax nexus, and pave the way for a consistent, nationwide approach for taxation of internet sales. It would be prudent to wait for the Court's decision on *Wayfair* before adopting a new sales tax collection regime.

- ESCO sales tax – Just a year ago, the Administration proposed and passed legislation to "clarify" and preserve the sales tax exemption for energy transmission services for energy purchased through an energy service company, or ESCOs. This year's Executive Budget reverses course and would repeal that exemption for all but residential customers, resulting in a $128 million per year increase in energy costs for manufactures and other businesses. New York businesses are already paying increased state assessments to support alternative energy and nuclear power, and we oppose this additional increase in state taxes on essential energy services.

- Right of Way fees - The Executive Budget would authorize up to $195 million in assessments, over a five-year period, on fiber optic companies using highway right of ways. This proposal runs contrary to the state's efforts to expand access to broadband, and singles out a single industry, and its customers, for increased funding for transportation infrastructure.

- "Opioid epidemic surcharge" – This new tax on the first sale of all opioids in the State is ostensibly for addressing the state's opioid abuse crisis, but only $18 million of its projected $127 million in new revenues is being used for that purpose. Over the last several years, New York State has enacted a significant number of regulatory and statutory measures in an effort to combat the growing prescription opioid and heroin epidemic. A tax on legal, medically necessary prescriptions will impose new costs on medical consumers, while failing to have any impact on opioid abuse.

- Tax Tribunal Appeals – The Executive Budget proposes to allow the Tax Department to appeal courts decisions of the state tax tribunal to the state courts. Since its inception, Tribunal decisions have only been appealable by taxpayers. New York and other states adopted independent tax tribunals to increase public confidence in the fairness of the state tax system by providing an independent agency with tax expertise to resolve disputes between the state and the taxpayer. This approach also provides all taxpayers with an accessible mechanism to appeal Tax Department determinations, so as to not restrict tax appeals to those with the ability to pay for extensive litigation. This proposal reverses that policy approach, and by promoting judicial challenges by the state, reduces access to due process and fundamental fairness for taxpayers without the financial wherewithal to engage in protracted litigation against the state.

Our testimony today focuses on tax related elements of the Executive Budget. The Business Council has interest in these and other spending and policy proposes contained in the Executive Budget, and will be sharing our additional budget issues and recommendations with Senate and Assembly members in the coming days.

Thank you again for the opportunity to testify today, and I welcome any questions or comments you have on these or other tax policy issues.

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