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# Written Testimony of the Fiscal Policy Institute For the Joint Legislative Budget Hearing on Taxes

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Tax policy in New York State is full of controversies. The State faces regular fiscal challenges to maintain the integrity of its existing programs in Medicaid, school aid, transportation funding, and other permanent programs, as well as consistent calls from policymakers and advocates across the political spectrum to expand the public provision of affordable housing, childcare, anti-poverty initiatives, and more. Meanwhile, anti-tax advocates argue that state taxes are too high, thereby creating a bad climate for business, and that our state income tax rates motivate the richest New Yorkers to move to other states.

This year is a particularly sensitive time for policy debates over state tax and revenue measures. The legislature has been handed the task of finding new funding sources for the MTA capital plan while the governor simultaneously pursues tax cuts; federal funding is liable to be reduced by billions of dollars annually, forcing the State to face hard choices between program reductions and tax increases; and all of this is before even reaching the need to *proactively* pursue policy measures to manage affordability challenges for working New Yorkers, which will require substantial new sources of revenue.

This testimony consists of 3 sections:

- (i) An overview of state tax statistics showing the extraordinary concentration of earning power in a small share of taxpayers;
- (ii) A critical assessment of the governor's proposed "middle class tax cut" and "inflation refund;" and
- (iii) Analysis of options for progressive tax reform to address both MTA funding needs as well as general revenue needs.

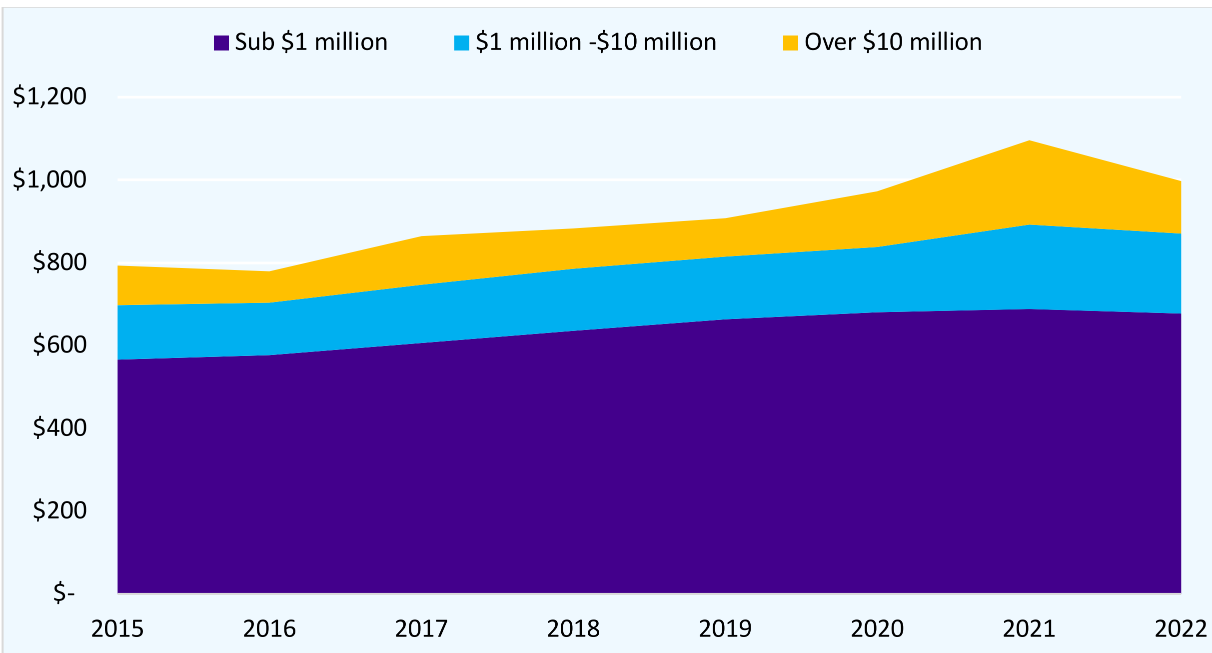
## I. State Tax Statistics

Earning power in New York State is highly concentrated in the hands of a small number of taxpayers. Out of a total population of about 10.7 million taxpayers (where a taxpayer is a tax filing unit, ranging from a single individual to a married couple with children), just 1.5 percent, or 165,000 taxpayers, earn over $1 million each year ("millionaire taxpayers").

In 2022, the 1.5 percent of millionaire taxpayers earned 32 percent of *all income* earned in New York. That is, 1.5 percent of taxpayers earned $320 billion of the $1.1 trillion in total personal income earned in New York.

The even smaller population of taxpayers earning over $10 million in annual income, merely 11,600 taxpayers—just 0.1 percent—earned about 12 percent of all income earned in New York State in 2022.

Figure 1. Total taxable income earned in New York State, by household income (billions)



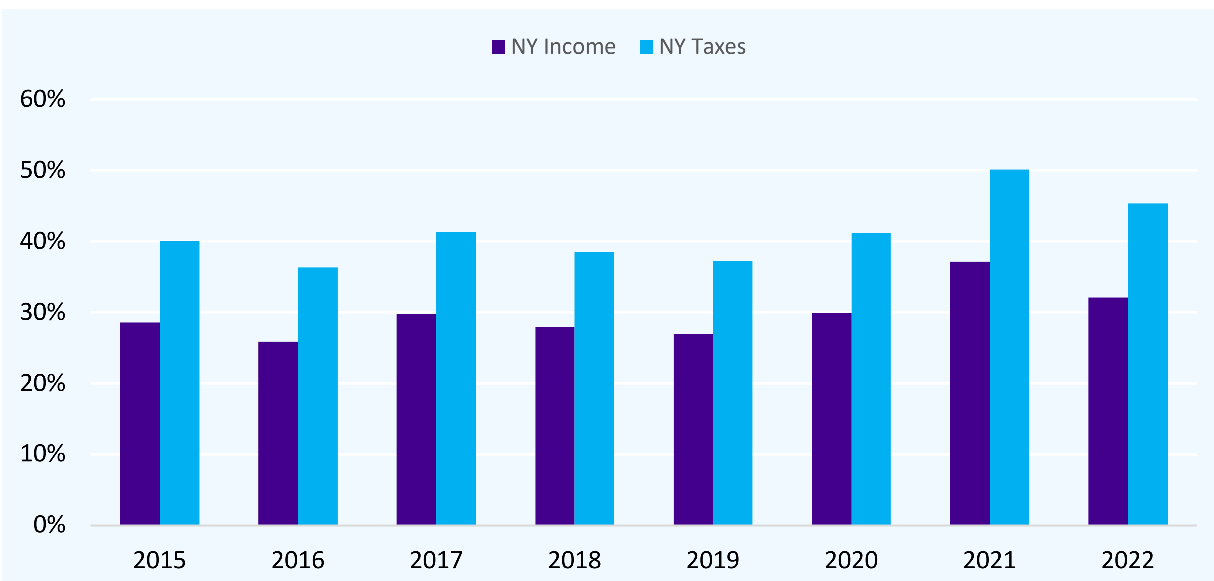

Anti-tax advocates frequently criticize the share of total tax liability paid by the highest earners without acknowledging the extraordinary share of total income earned by this population. Three specific criticisms are typically made: first, that it is unfair for a small share of the population to shoulder such a large share of the tax burden; second, that the state's revenues are unstable due to this reliance on a small share of taxpayers; and third, that these taxpayers move in response to income tax rates, further undermining state fiscal stability.

Each of these arguments is mistaken. In terms of fairness, Because such a large share of total income is earned by the highest earners, they would shoulder a substantial share of the total tax burden even under a flat-rate income tax. Because the Personal Income Tax rates are modestly progressive, millionaire taxpayers pay slightly more in total tax liability than they earn in total income, but the burden is still generally proportional to the earning power of this population.

With respect to the other two arguments, which are more practical—fiscal stability and migration risk—there is also little reason to be concerned. New York State's millionaire population has steadily risen over the years, powered by the virtually unique strength of the metro area's economy. The concentration of global investment firms, law firms, consulting firms, medical centers, and other elite professional services, means that the urban economy both reliably produces *new* millionaires, and that those who are already high earners are generally tethered to firms based in the City and continue to pay tax to New York State (see Figure 4 below and accompanying discussion). Further, FPI's empirical research of migration patterns shows that the top 1 percent of income earners move less frequently than all other income groups (about ¼ the rate) and does not move in response to tax increases.[1]

In the 2021 the State raised Personal Income Tax rates on the highest earners, leading to a slightly more progressive distribution of the tax burden, but one that is still basically proportional to the tremendous share of income earned by this group. We see that millionaire taxpayers generally earn about one-third all income earned in New York State and now pay about 45 percent of all tax liability.

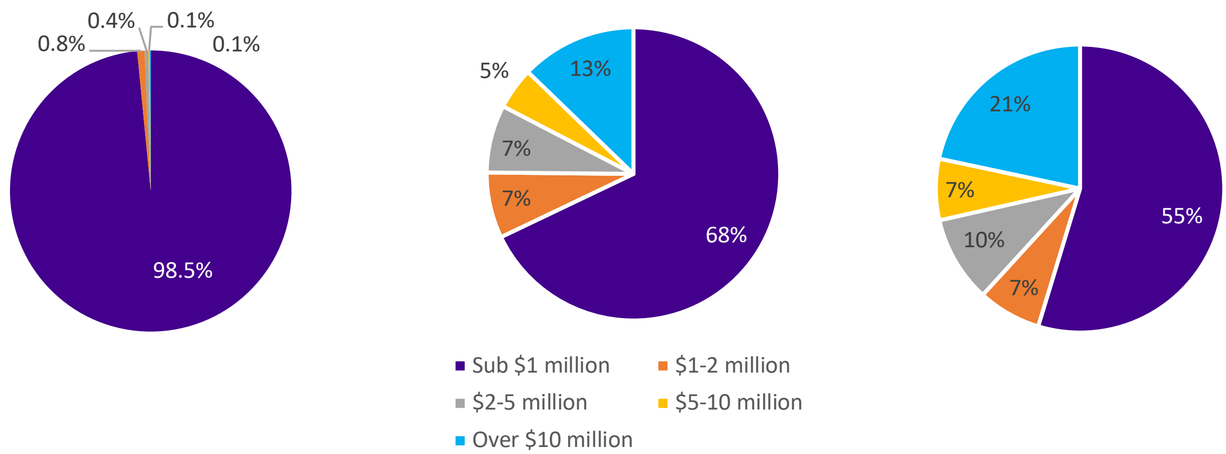
Figure 2. Share of income earned and taxes paid by tax filers earning over $1 million per year




When we examine tax liability share by income group, we see that the 98.5 percent of sub-millionaire taxpayers pay 55 percent of all tax liability—slightly lower than their share of all income at 68 percent. Again, this reflects modest progressivity in the income tax.

[1] See fiscalpolicy.org/migration

Figure 3. Share of population, share of total income, and share of tax payments by household income




One important fact about state tax policy is that nonresidents *still pay income tax* on their earnings from working in New York. Many of the highest earners live outside of the state but continue to work in New York City, as the City is one of a small number of global cities that can serve as a hub for elite firms.

As shown below, over 60 percent of millionaire taxpayers live in other states (principally New Jersey and Connecticut) but continue to pay New York State tax.

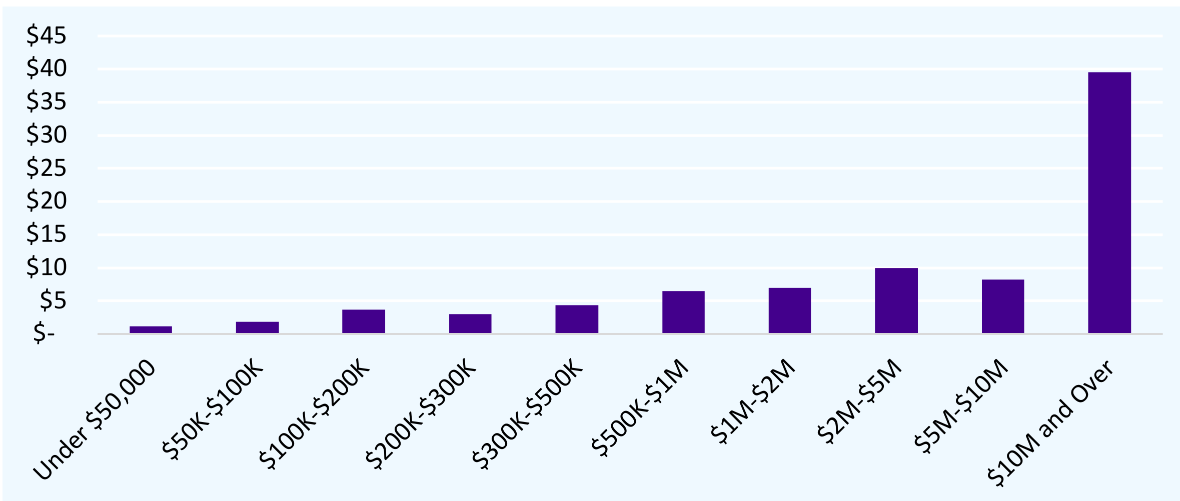
Figure 4. Share of tax filers in each residency group, by and income level

Part of the explanation for the earning power of millionaire taxpayers is that they generally make their income from investing and owning businesses rather than wages and salaries. Many of these taxpayers are owners of investment firms, law firms, consulting firms, or real estate investors. As shown below, the millionaire taxpayer population predominantly earns business profits and investment income, not wages, and they also take home most of the investment income and business profits earned in the state.

78 percent of all capital gain (income from the sale of investment assets) is earned by millionaire taxpayers, and 53 percent of all capital gain is earned by taxpayers making over $10 million.

Figure 5. Aggregate capital gains income for New York taxpayers in 2022, by household income

*Billions of Dollars ($)*

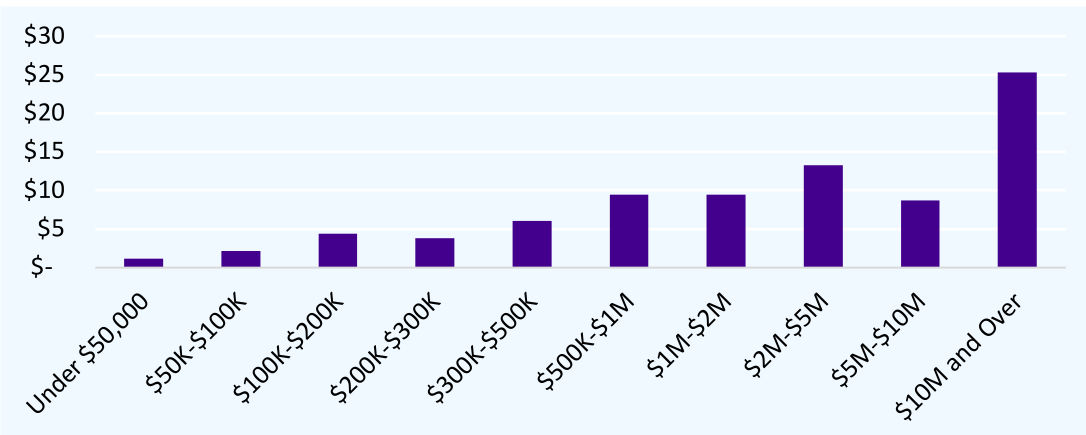


Similarly, income from business profits is also highly concentrated among the millionaire taxpayer population. This category generally captures income from owning an interest in a partnership, LLC, or S corporation, as well as ownership of real estate (rents) or intellectual property (royalties). 71 percent of non-corporate business profits are earned by millionaire taxpayers.

While many lawmakers mistakenly believe that businesses organized as LLCs, partnerships, and S corporations are all "small businesses," state tax data show that in fact a large majority of the income earned by these businesses flows to the richest 1.5 of taxpayers.

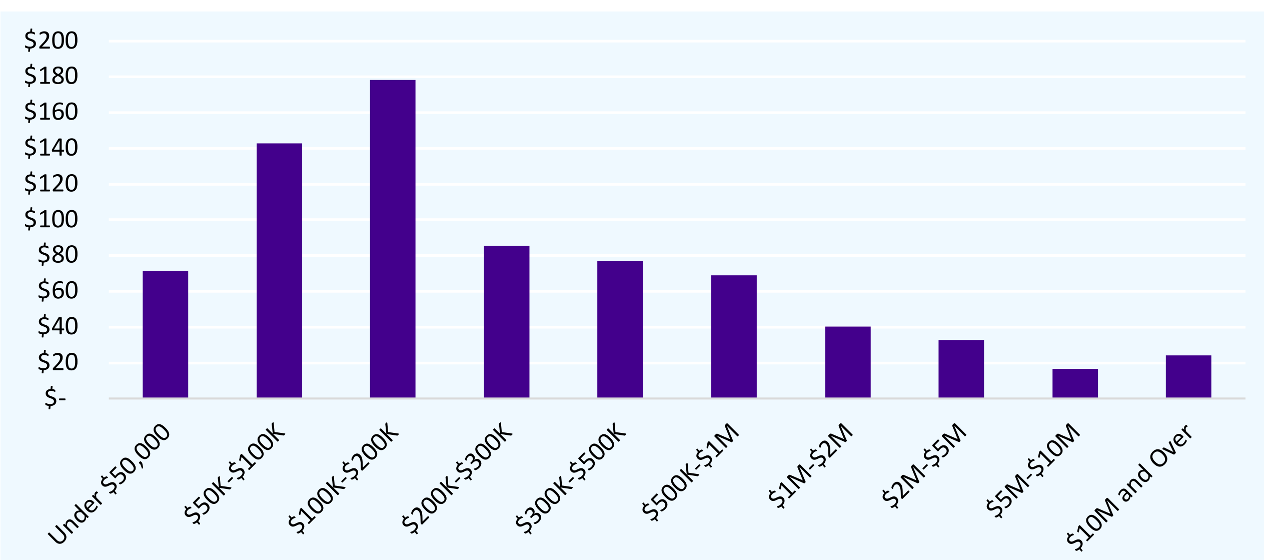
Figure 6. Aggregate income from rents, royalties, partnerships, estates, and trusts for New York taxpayers in 2022, by household income

*Billions of Dollars ($)*




Conversely, millionaire taxpayers early a relatively small share of all wage and salary income earned in New York. It is overwhelmingly middle income earners who are compensated in wages and salaries.

Figure 7. Total aggregate wage and salary income for New York tax filers in 2022, by household income



## II. The Governor's Middle Class Tax Cut and Inflation Rebate

Two of the governor's signature tax-related initiatives in the executive budget are the "inflation refund" and "middle class tax cut". Each initiative ought to be rejected by the legislature.

### *Inflation Refund: A waste of $3 billion*

The inflation refund is very costly, untargeted, and will have a negligible impact on the majority of recipients. Under the governor's proposal, joint filers making up to $300,000 per year would receive a one-time payment of $500 and single filers making up to $150,000 per year would receive a one-time payment of $300. In total, the payments would go to about 8.6 million taxpayers and would cost the State $3 billion. The $3 billion that the governor would commit to it could be better spent elsewhere, such as by paying down the unemployment insurance trust fund debt, or investing in publicly-financed mixed-income housing development.

A policy of this nature—sending modest checks to many people—could also have the adverse impact of actually *increasing* price inflation, as it looks more like a stimulus policy than a measure to reduce cost pressures. If implemented, the policy could easily backfire, giving a small boost to prices rather than easing household finances. This policy will also do very little to alleviate the stresses imposed by inflation and other cost-of-living increases. For example, the median renter household in New York saw an increase in rent of almost $250 *per month* between 2020 and 2023—meaning that the annual expense for the median renter increased by $3,000 from rent alone. A $500 check barely puts a dent in the household budgets keeping New Yorkers up at night, and it does nothing to change these cost trends.

By contrast, $3 billion could be deployed to capitalize the governor's revolving loan proposal (which she would fund with only $50 million) to build mixed-income housing. A revolving loan fund capitalized with $3 billion could feasibly be used to produce 45,000 additional units of housing every five years, putting a significant dent into the housing supply needs of the state.

### *Middle Class Tax Cut: Bad policy, especially given MTA funding needs*

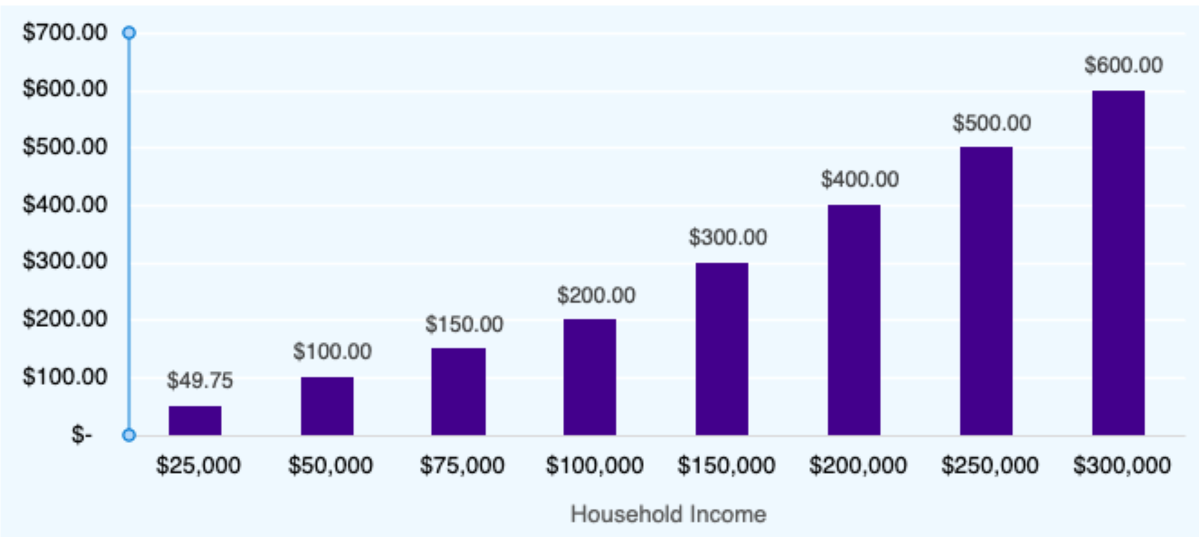
The governor's proposed "middle class" tax cut would reduce the Personal Income Tax rate for households making up to $323,200 per year (for joint filers), at an estimated cost to the State of $1 billion.

The proposed tax cut is bad policy for three reasons. **First**, while purporting to benefit the middle class, it primarily benefits upper-income groups (though not the highest earners). **Second**, tax cuts undermine the State's fiscal stability and revenue expectations, thereby damaging the public programs such as transit, public education, and Medicaid that provide the most benefit to working and middle-class households. It is highly unlikely that policymakers would be willing to raise taxes on these income groups in the future, meaning that tax cuts translate into permanent revenue losses that will grow over time. **Third**, at a time when the legislature is looking to *raise* taxes to fund the MTA capital plan, it makes little sense to simultaneously cut taxes.

The governor's proposed tax cut follows a substantially larger "middle class" tax cut that was enacted in the fiscal year 2017 budget and fully phased in by fiscal year 2024. The executive branch estimated that these prior tax cuts would cost $4.2 billion by 2025; now the governor plans to increase the cumulative revenue loss from a decade of "middle class" tax cuts to over $5 billion annually. This is more than the total revenue raised from the top Personal Income Tax and Corporate Franchise Tax rates.

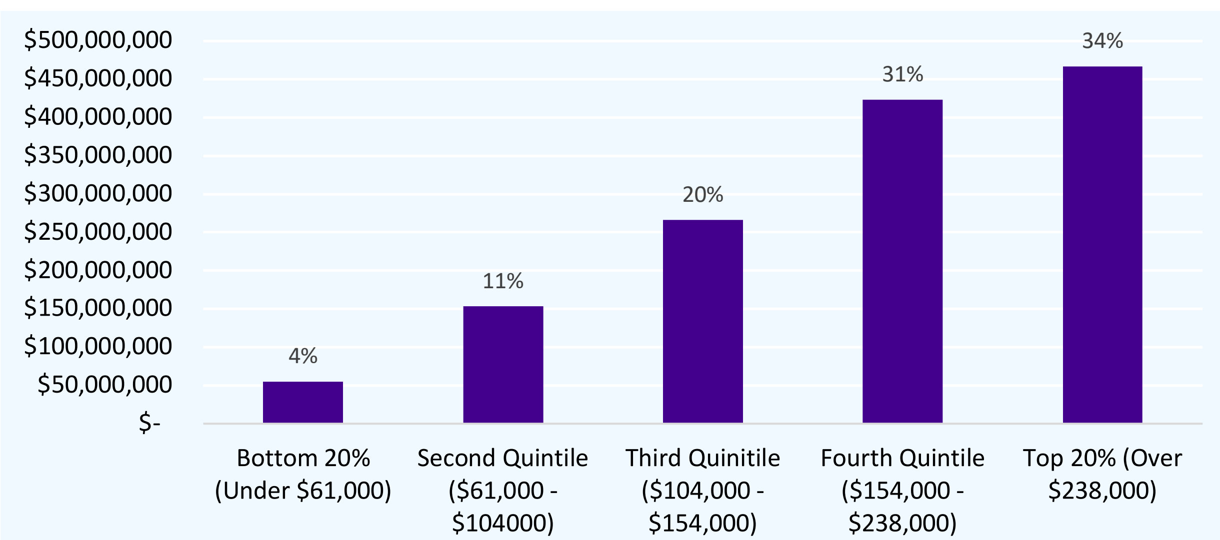
As shown below, truly middle class households (households concentrated around the median income of about $80,000) in New York will receive negligible benefit of just about $15 each month. Higher income households will receive a larger benefit, although one that will likely go unnoticed—just $50 per month for a family making $300,000.

Figure 8. Annual benefit of proposed tax cut for New York households (by income group)




At the aggregate level, 65 percent of the $1 billion estimated cost of the tax cut would go to benefit households making more than $150,000, with just 35 percent benefitting the bottom 60 percent of taxpayers.

Figure 9. Share of total tax cost (by income group)



# III. Progressive Revenue Options

## The Personal Income Tax

The Personal Income Tax (PIT) is the most important source of revenue for the State, accounting for nearly $80 billion of tax collections. And in light of the wealth of New York's millionaire taxpayer population, there is plenty of room to continue increasing progressive tax rates on the highest earners.

The conventional objection to further increasing top tax rates is that they will motivate tax flight, or "tax migration," by top earners searching for lower state income tax rates. Prior FPI research has refuted these arguments (see here and here), showing that the top 1 percent of income earners generally move at much lower rates than all other income groups, that they do not move in response to tax increases, and that when they do move out of state they most often move to other states with similar tax profiles.

### *Increasing progressivity in the income tax*

The current top PIT rates, which apply to single filers making over $1.08 million and joint filers making over $2.16 million, were enacted in 2021 and are set to expire in calendar year 2027, but would be extended through calendar year 2032 by the executive budget for fiscal year 2026.

New York's top rates are imposed on an unusual and peculiar bracket structure. Unlike peer states New Jersey and California, which impose their top tax rate on a general million-dollar bracket, New York State created a $5 million and $25 million tax bracket. There is no particular reason of either fairness or fiscal stability for distinguishing among taxpayers who make millions of dollars per year, and the State would be wise to consolidate these top brackets.

Table 1. Top state tax rates for married filers

| State | Top Tax Bracket | Top Tax Rate |
|---|---|---|
| New York | $ 25M | 10.9% |
| California | $ 1.4M | 13.3% |
| New Jersey | $ 1M | 10.75% |
| Hawaii | $ 200,000 | 11.0% |

***Option 1: Combine brackets of all taxpayers earning over $1 million per year at top rate***

Simply consolidating the top brackets into a single millionaire bracket with the current top rate would raise over $2 billion annually.

Table 2. Combine millionaire tax brackets

Additional Revenue: $2.1 billion

| Current Schedule | | | | Proposed Schedule | | | |
|---|---|---|---|---|---|---|---|
| Single Filer | | Joint Filer | | Single Filer | | Joint Filer | |
| Income | Tax Rate | Income | Tax Rate | Income | Tax Rate | Income | Tax Rate |
| $1.08M | 9.65% | $2.15M | 9.65% | $1.08M | 10.9% | $2.15M | 10.9% |
| $5M | 10.3% | $5M | 10.3% | $5M | 10.9% | $5M | 10.9% |
| $25M | 10.9% | $25M | 10.9% | $25M | 10.9% | $25M | 10.9% |

Tax increases should not necessarily be *limited* to the millionaire taxpayer population. While it has become something of a taboo in state policy discourse to propose tax increases on anyone making under $1 million, it must be recognized that many sub-millionaire households are still in the economic elite.

***Option 2: Increase rates by 1 percentage point, starting at upper-middle class brackets***

An across the board rate increase of 1 percentage point for all households in the top 8 percent of taxpayers—those making over $323,300 for a married couple (or $215,400 for a single filer) would raise $5.4 billion.

Table 3. Increase rates by 1 percentage points on the top 8 percent of households

Revenue: $5.4 billion

| Current Schedule | | | | Proposed Schedule | | | |
|---|---|---|---|---|---|---|---|
| Single Filer | | Joint Filer | | Single Filer | | Joint Filer | |
| Income | Tax Rate | Income | Tax Rate | Income | Tax Rate | Income | Tax Rate |
| $215,400 | 6.85% | $323,200 | 6.85% | $215,400 | 7.85% | $323,200 | 7.85% |
| $1.08M | 9.65% | $2.15M | 9.65% | $1.08M | 10.65% | $2.15M | 10.65% |
| $5M | 10.3% | $5M | 10.3% | $5M | 11.3% | $5M | 11.3% |
| $25M | 10.9% | $25M | 10.9% | $25M | 11.9% | $25M | 11.9% |

### *Option 3: Increase overall progressivity*

A more significant change to the PIT would be to significantly increase the overall progressivity by raising top tax rates by multiple percentage points and adding a tax increase on single filers making over $500,000 and married couples making over 750,000.

Table 4. Raise top tax rates & increase progressivity throughout income distribution

Revenue: $7.6 billion

| Current Schedule | | | | Proposed Schedule | | | |
|---|---|---|---|---|---|---|---|
| Single Filer | | Joint Filer | | Single Filer | | Joint Filer | |
| Income | Tax Rate | Income | Tax Rate | Income | Tax Rate | Income | Tax Rate |
| $215,400 | 6.85% | $323,200 | 6.85% | $215,400 | 6.85% | $323,200 | 6.85% |
| | | | | $500,000 | 8.85% | $750,000 | 8.85% |
| $1.08M | 9.65% | $2.15M | 9.65% | $1.08M | 11% | $1.5M | 11% |
| | | | | $2M | 12.0% | $3M | 12.0% |
| $5M | 10.3% | $5M | 10.3% | $5M | 13.0% | $5M | 13.0% |
| $25M | 10.9% | $25M | 10.9% | $25M | 14.0% | $25M | 14.0% |

***Option 4: Invest in Our New York Proposal (A.1281/S.1622)***

Finally, we estimate the revenue from the legislative package supported by the "Invest in Our New York" coalition, which has numerous supporters in the Assembly and Senate, at $21.1 billion per year. The proposed rate schedules are below.

Table 5. Significantly increase rates and overall progressivity

Revenue: $21.1 billion

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<tr><th colspan="4">Current Schedule</th><th colspan="4">Proposed Schedule</th></tr>
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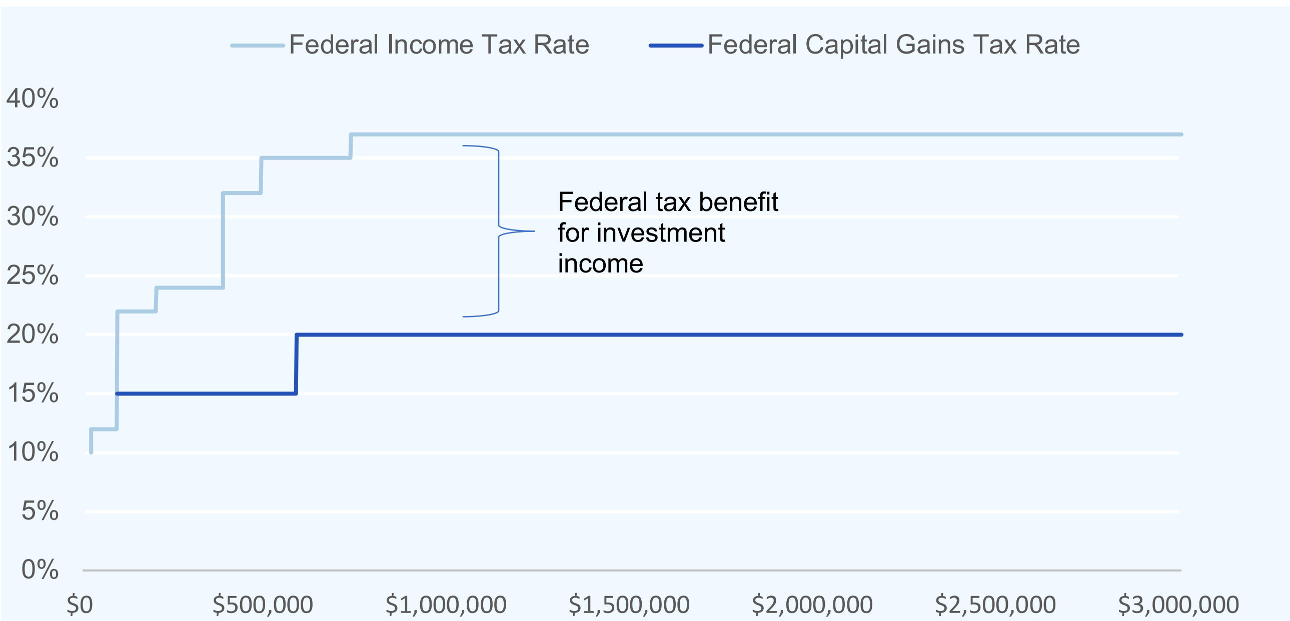
## Taxing Investment Income

The tax law treats individual income as falling into one of two categories: (i) ordinary income, which includes salaries, wages, and bonuses (among others) and (ii) capital gain, which generally includes income from investments. Individuals who earn capital gains benefit from lower federal income tax rates.[2] While the top U.S. federal income tax rate is 37 percent for a married couple filing jointly with earnings over $730,000, the top long-term capital gains rate is 20 percent for a married couple earning over $583,000.

Figure 10. Capital gains tax benefit (federal)




As shown above (Figure 5), nearly all income from investing (capital gain) is earned by the top taxpayers—with 84 percent going to those making over $500,000, just 3.5 percent of taxpayers. And over 50 percent of all capital gain is earned by the 0.1 percent of taxpayers making over $10 million per year.

[2] The preferential federal income tax rates apply to long-term capital gains and qualified dividends. For the sake of simplicity, this chapter refers to these types of income simply as "capital gains".

A tax of just a few percentage points on these top income groups would raise billions of dollars annually (as modeled below). Or, as has been proposed by some state legislators, the state could entirely offset the lower federal tax rate on capital gains with a high surtax of 15 percent, leading to a far higher revenue yield.

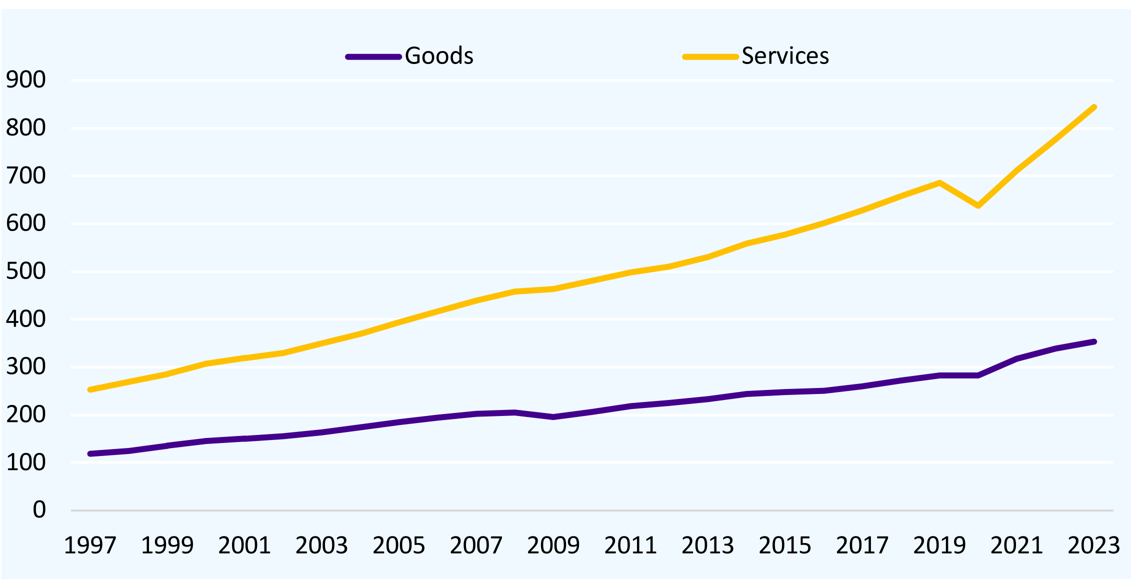
Table 6. Revenue estimates for capital gains surtaxes

| Proposal | Income | | | Total Revenue |
|---|---|---|---|---|
| | < $500,000 | $500,000-$1,000,000 | > $1,000,000 | |
| Low Surtax | 0% | 1% | 2% | $1.9 billion |
| Moderate Surtax | 0% | 2% | 4% | $3.9 billion |
| Highest Surtax | 0% | 7.5% | 15% | $14.5 billion |

## Extending the Sales Tax to Services

The sales tax is almost exclusively imposed upon consumer purchases of goods. As shown below, services are a much larger component of total consumer expenditures in New York. Many countries impose a sales tax (in the form of a Value Added Tax) on both goods and services, as this broader tax base can finance expansive social spending programs. A truly broad-based sales tax on services could raise $7-8 billion for each percentage point of the tax.

Figure 11. Consumer expenditures in New York *(Billions of dollars)*




*Source: U.S. Bureau of Economic Analysis, Personal Consumption Expenditures*

## Taxing Business Profits

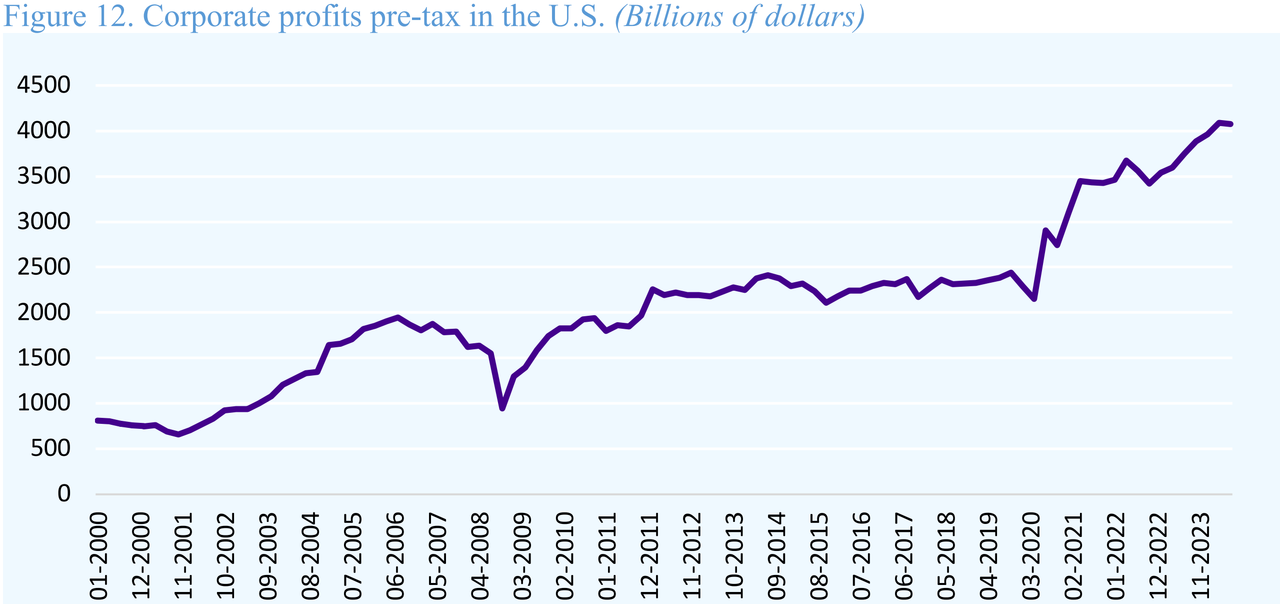
Taxing business profits generally must take the form of either a tax on corporate income or a tax on the income of non-corporate businesses such as partnerships, LLCs, and S corporations ("pass-through businesses"). As shown above (Figure 6), most of the profits earned by owners of pass-through businesses goes to millionaire taxpayers, not small businesses as is often believed. Extending the current corporate tax to all pass-through businesses could raise $8-9 billion annually.

The State already imposes a tax on corporate profits—the Corporate Franchise Tax (CFT). As with all state corporate income taxes, the tax is "apportioned" based on the share of the corporation's profits that are attributable to their business activities in the state. That is, a corporation doing business in both New York and New Jersey is not subject to tax by both states on *all* of its profits. Instead, each state is only entitled to tax its fair share of the corporation's profits, determined under a scheme that approximates the profit attributable to business activities within that state. In New York, the formula is based exclusively on a corporation's sales into the state. This is known as the single sales factor apportionment. Before 2015 the formula included other factors, but was changed to ensure that corporations would have no incentive to move their offices or operations for tax reasons. Moreover, this change to the corporate tax shifts more of the burden to out-of-state corporations.

In other words, contrary to the common belief that corporations are taxed based on the location of their headquarters, the location of a corporation's offices or employees *does not matter* and the CFT rate creates *no incentive* for corporations to relocate. In order to reduce its CFT liability, a corporation would have to decrease its sales in New York State and therefore reduce its profits by more than it would save on taxes.

Corporate profits have risen dramatically since prior to the pandemic, as shown below.

Figure 12. Corporate profits pre-tax in the U.S. *(Billions of dollars)*




*Source: U.S. Bureau of Economic Analysis, National income: Corporate profits before tax (without IVA and CCAdj)*

The current top CFT rate is 7.25 percent, imposed only on corporations with over $5 million in profits. This rate is set to expire in calendar year 2026, leading to an annual expected revenue loss of about $1 billion.

Making the CFT rate of 7.25 percent permanent would yield another $950 million dollars. Further increases, shown below, could yield substantial additional revenue.

Table 7. Revenue raised under various corporate tax scenarios *(Millions of dollars)*

| Tax Rate | Revenue Raised |
|---|---|
| 6.50% | $ 8,300 |
| 7.25% | + $ 950 |
| 10.00% | + $ 4,500 |
| 20.50% | + $ 17,500 |