



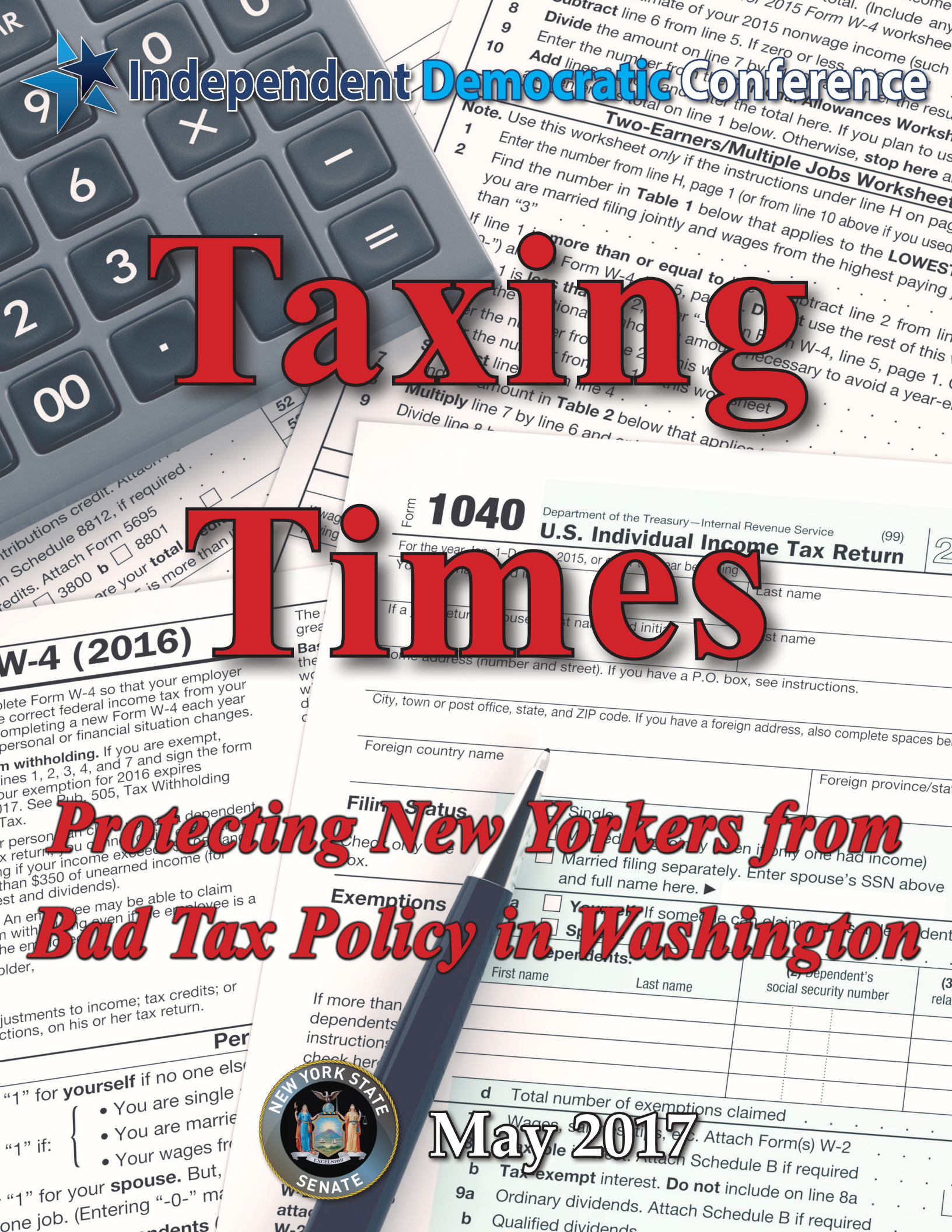
# Independent Democratic Conference

# Taxing

# Times

## Protecting New Yorkers from Bad Tax Policy in Washington

May 2017



## Introduction:

The United States has allowed taxpayers to deduct state and local taxes from their income when determining their taxable federal income from the first moment that federal income taxes came into existence<sup>1</sup>. This policy is meant to prevent a situation where rising federal tax rates would crowd state and local governments out, by making it too onerous for them to raise their own taxes for fear of driving residents away. In addition to maintaining a balance between the taxing needs of different levels of government, many have argued that this deduction prevents double taxation of individual's incomes<sup>2</sup> as well.

President Trump and his administration have touted a new tax plan<sup>3</sup> they call "tax reform" that promotes cutting deductions as a way to make up revenues lost by cutting individual and corporate tax rates, and his close allies in Congress like House Speaker Paul Ryan have also put out tax plans<sup>4</sup> that would end this deduction. Ending the ability to deduct local and state taxes from one's income for federal purposes if one chooses to itemize their deductions would result in a net tax increase for millions of New Yorkers. A third of New York state filers claim this itemized deduction<sup>5</sup>, with the average deduction in 2014, the last year for which detailed data exists, being \$21,000.<sup>6</sup> A report by Governor Cuomo's office in 2013 estimated that based on 2010 numbers, eliminating this deduction would increase federal taxes on New Yorkers by \$14.8 billion<sup>7</sup>.

A new estimate by the Independent Democratic Conference finance staff using 2014 tax data estimates that New Yorkers stand to see their federal taxes increase by \$21 billion if this deduction is eliminated. New Yorkers cannot afford such a massive tax increase. The IDC, led by State Senator Jeff Klein, urges our Congressional delegation to do all it can to prevent any actions at the federal level that would simultaneously increase taxes on a larger number of New Yorkers while also leading to inadequate funding for programs that millions of New Yorkers rely upon.

At the same time, the IDC will also do what is necessary at the state level to protect taxpayers from the effects that eliminating this deduction would have for individuals filling out their New York income tax returns. Eliminating the state and local tax itemized deduction at the federal level would have implications for homeowners state level deductions. Currently, taxpayers can deduct their property taxes on their state income tax return if they itemize their deductions, but only if they have claimed the federal itemized deduction first. If this federal itemized deduction were repealed, then state taxpayers would no longer be able claim an itemized deduction for their property taxes on their state return. **This would mean an increase in taxes of at least \$704 million for New Yorkers.** In order to prevent this from happening, the IDC is introducing legislation that would ensure that the ability of New Yorkers to claim an itemized property tax deduction on their

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<sup>1</sup> [https://taxfoundation.org/state-and-local-tax-deduction-primer/#\\_ftn10](https://taxfoundation.org/state-and-local-tax-deduction-primer/#_ftn10)

<sup>2</sup> <https://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/Impact-of-Federal-Tax-Proposals.pdf>, pgs. 17-18

<sup>3</sup> <https://assets.donaldjtrump.com/trump-tax-reform.pdf>

<sup>4</sup> <http://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-PolicyPaper.pdf>

<sup>5</sup> <http://www.urban.org/sites/default/files/2000693-revisiting-the-state-and-local-tax-deduction.pdf>

<sup>6</sup> <http://www.taxpolicycenter.org/publications/repeal-state-and-local-tax-deduction/full>

<sup>7</sup> <https://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/Impact-of-Federal-Tax-Proposals.pdf>

state returns would remain unchanged, even in the face of action in Washington to eliminate the state and local tax deduction.

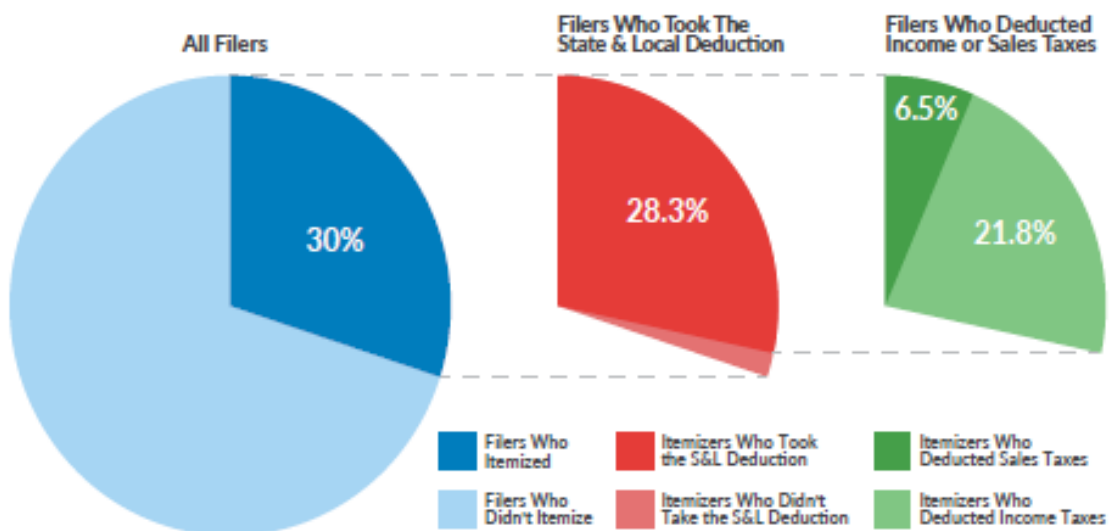
### The State and Local Tax Itemized Deduction:

The ability to deduct state and local taxes from one’s federal taxes has existed since the very creation of a federal income tax. The very first income tax at the federal level was created by the Revenue Act of 1862, meant to help finance the Civil War<sup>8</sup>. This law allowed individuals to deduct any state and local taxes paid from their income for the purposes of calculating their liability. The modern income tax system was born after the passage of the 16<sup>th</sup> Amendment in 1913 and the revenue act passed that year continued the practice of allowing filers to deduct their state and local taxes from their income taxes. This deduction remained unchanged until 1964, when the ability to deduct license fees and excise taxes on alcohol and tobacco products was ended. Soon thereafter, the ability to deduct motor fuel taxes was also eliminated<sup>9</sup>.

The most ambitious attempt to eliminate this deduction came in 1986, under the Reagan administration. At the time, the administration only succeeded in removing the ability of individuals to deduct local and state sales taxes from their income tax, though this policy was eventually partly reversed in 2004 when taxpayers were given the ability to choose whether to deduct income taxes or sales taxes<sup>10</sup>.

FIGURE 1.

### What Percentage of Taxpayers Take the State & Local Deduction?



At the national level, as shown by the figure above from the Tax Foundation<sup>11</sup>, almost all individuals who itemize their deductions claim a deduction for state and local taxes. This figure

<sup>8</sup> [https://taxfoundation.org/state-and-local-tax-deduction-primer/#\\_ftn18](https://taxfoundation.org/state-and-local-tax-deduction-primer/#_ftn18)

<sup>9</sup> Ibid.

<sup>10</sup> [https://www.cbo.gov/sites/default/files/110th-congress-2007-2008/reports/02-20-state\\_local\\_tax.pdf](https://www.cbo.gov/sites/default/files/110th-congress-2007-2008/reports/02-20-state_local_tax.pdf)

<sup>11</sup> <https://files.taxfoundation.org/20170315142330/Tax-Foundation-FF545.pdf>

breaks this down further into the percentage that claim a deduction for state or local income taxes and those who claim a deduction for state or local sales taxes. While any taxpayer may choose to deduct either sales or income taxes, in most jurisdictions that impose an income tax, the filers will choose to deduct their income taxes, as they will likely be higher. Not shown in this figure is that individuals who itemize their deductions can also claim a deduction for real property taxes. Some states charge property taxes on items like cars, and those can be deducted. New York only charges real property taxes on real estate, and filers are able to deduct real property taxes paid for their primary residence.

**The Cost to New York:**

New Yorkers would be affected by the elimination of the itemized deduction of state and local taxes more than residents in most other states. A report by the Tax Policy Center<sup>12</sup> shows, 34.6% of tax filers from New York apply for this itemized deduction, with an average deduction claimed of \$20,489 in 2013, which grew to \$21,000 in 2014<sup>13</sup>. New York had the largest average deduction claimed in the country, claiming 13.2% of the total deductions claimed nationally. Only California, which had 80% more individuals than New York claim the deduction, accounts for a larger percentage of the national share.

In 2013, the Governor’s Office issued a report on the possible effects proposed changes to federal tax policy could have on New Yorkers . One of the policy changes discussed in the report was the elimination of the itemized deduction for state and local taxes. In that report, the Executive estimated that a total of 3.28 million New Yorkers would see an average tax increase of \$4,500, for a total tax increase of \$14.8 billion<sup>14</sup>. This analysis utilized detailed tax data from 2010.

**IDC Updated Analysis:**

The most recent detailed data of federal tax returns comes from 2014<sup>15</sup>. That data shows that in 2014, 3.3 million filers in New York claimed itemized deductions for state and local income and sales taxes and real property taxes. Local state and local income taxes were the most commonly deducted, with real estate taxes coming in second. Surprisingly, over 364,000 New Yorkers chose to deduct sales taxes in 2014 as opposed to income taxes. In total, New York filers in 2014 who itemized their deductions claimed \$68.4 billion in 2014, up from the \$66.9 billion in 2013.

Type of Local Tax	Number of Filers in NY Claiming Deduction in 2014	Total Deduction Claimed (In millions)
State and Local Income Taxes	2,839,750	\$ 47,302
Real Estate Taxes	2,375,850	\$ 20,158
Sales Taxes	364,730	\$ 2,376
<b>Total</b>	<b>3,251,300</b>	<b>\$ 68,401</b>

<sup>12</sup> <http://www.urban.org/sites/default/files/2000693-revisiting-the-state-and-local-tax-deduction.pdf>

<sup>13</sup> [http://www.taxpolicycenter.org/sites/default/files/publication/138871/salt\\_0.pdf](http://www.taxpolicycenter.org/sites/default/files/publication/138871/salt_0.pdf)

<sup>14</sup> <https://www.governor.ny.gov/sites/governor.ny.gov/files/archive/assets/documents/Impact-of-Federal-Tax-Proposals.pdf>

<sup>15</sup> Statistic available at: <https://www.irs.gov/uac/soi-tax-stats-historic-table-2>

IDC finance staff examined detailed tax data from both the IRS and the Department of Tax and Finance from 2014, the last year available, to come up with an estimate of the cost to taxpayers of removing the deduction. We used federal tax data, which breaks down the amounts deducted by income bands, and then calculated the tax value of the deductions by multiplying the amount of the deduction by the income tax rate for those individuals. The IRS data does not break down the filers by filing class, so staff calculated the cost first using rates for single filers, and then the rates for joint filers, and then took the average of the resulting amounts. We then divided these amounts by the number of filers who took the relevant deductions:

Type of State or Local Tax	Total Deductions Claimed (In Thousands of \$)	Value of Deductions (In Thousands of \$)	Number of Filers claiming the deduction	Value per filers
Real property Taxes	\$20,158,375.00	\$5,266,850.86	2,375,850	\$ 2,216.83
State and Local Income Taxes	\$47,302,123.00	\$15,045,552.51	2,839,750	\$ 5,298.20
<b>All State and Local Taxes</b>	<b>\$68,400,903.00</b>	<b>\$21,049,806.20</b>	<b>3,251,300</b>	<b>\$ 6,474.27</b>

Based on our calculations, the federal deduction on real property taxes was worth approximately \$5.27 billion to New Yorkers, with the average value for those who claimed it being \$2,216 dollars. The value of the state and local income tax was \$15 billion, with an average value of \$5,298 per filer who claimed the deduction. **In total, the value to New York taxpayers is estimated to be \$21.05 billion, with the average value per filer being \$6,474.** <sup>16</sup>

The IDC also looked at county-level tax filer data from 2014 to determine the impact to different regions of the state from the loss of this deduction. Staff examined data on deductions at the county level by income levels to come up with an estimate of how much in the state and local taxes paid deduction filers in each county might be claiming. We assumed that the amounts being claimed by filers at different income levels remain consistent statewide. Once we had an estimate of what percentage of the state and local deduction is being claimed by taxpayers in each county, we grouped the counties by the economic development regions of the state:

Economic Development Region	Regional Share of Deductions
New York City	44.96%
Long Island	20.85%
Mid-Hudson	17.82%
Western NY	3.65%

<sup>16</sup> These numbers are significantly higher than those in the report by the Governor issued in 2013. Of course, as noted, that report was using detailed 2010 tax filer data. Incomes, particularly for those in the upper income brackets have recovered significantly since the Great Recession, and income federal income tax rates increased in 2013 for those in the higher income brackets. The higher rates make the value of deductions increase.

Capital Region	3.63%
Finger Lakes	3.60%
Central NY	2.12%
Southern Tier	1.59%
Mohawk Valley	1.02%
North Country	0.77%

As in the Executive’s 2013 report, downstate dominates, with New York City accounting for about 45% of the deductions being claimed, followed by Long Island the Mid-Hudson Valley.

**What Trump’s Tax Plan Means to New Yorkers:**

1. An attorney and a professor living in Riverdale in The Bronx with two dependent children would have a median income of \$253,780.<sup>i</sup> Their state and local taxes would amount to \$28,965 (\$16,369 in state income taxes, \$9,263 in New York City income taxes<sup>ii</sup>, and \$3,333<sup>iii</sup> in property taxes). Claiming the state and local deduction as opposed to the standard deduction would save them \$4,638 in federal taxes. They would save \$214.98 of their New York income tax bill by deducting their property taxes.
2. A married couple in Nyack with one child, a high school teacher and an accountant, have a median income of \$175,360 per year.<sup>iv</sup> Their state and local tax deduction would be worth \$21,847 in total, with \$11,661 in state income taxes,<sup>v</sup> and \$10,190 in property taxes.<sup>vi</sup> With current federal deductions for state tax expense, this couple saves \$6,886 per year on their federal tax bill if they claimed the itemized deduction as opposed to a standard deduction.<sup>vii</sup> This couple would save \$677.37 of their New York income tax return by deducting their property taxes.
3. A nurse practitioner in Queens with one child would have a median income of \$108,710 per year.<sup>viii</sup> The nurse practitioner owes \$7,229 in state income taxes, \$3,968 in city income taxes,<sup>ix</sup> and \$3,589<sup>x</sup> in property taxes, for a total state and local tax exemption of \$14,794. Filing as a head of household, this nurse practitioner would save \$1,361 in their federal tax bill. This nurse would save \$239.27 from their New York income tax return by deducting their property taxes.
4. A married couple living in Mineola, who are a software engineer and a distribution manager without any current dependents, would have a median income of \$217,850<sup>xi</sup>. Their state and local tax deduction would be worth \$24,577, consisting of \$14,487 in state income taxes<sup>xii</sup> and \$10,090 in property taxes<sup>xiii</sup>. This couple would save \$3,410 annually by claiming the state and local deduction as opposed to the standardized deduction. They would save \$670.98 on their New York income tax returns by deducting their property taxes.
5. A married couple in Staten Island, for instance a mental health social worker and a photographer with two children, have a median income of \$106,410 per year.<sup>xiv</sup> They have to pay \$7,076 in state income taxes, \$3,884 in city income taxes,<sup>xv</sup> and \$3,763 in property

taxes.<sup>xvi</sup> If they can claim the itemized deduction of \$14,723 instead of the standardized deduction, they would stand to save \$8,129 thanks to this deduction bringing them down by one tax bracket, from a federal rate of 25% to a rate of 15%. This couple would save \$250.21 in their New York income tax returns from deducting their property taxes.

6. A couple in Ronkonkoma with one child, where one parent is an engineer and the other a budget analyst, would have a median income of \$179,420 a year.<sup>xvii</sup> This couple would owe \$11,931 in state income taxes<sup>xviii</sup> and \$7,201 in property taxes<sup>xix</sup>, for a total deductible amount of \$19,132. Claiming the itemized deduction instead of the standard deduction would save this couple \$6,329 on their federal tax bill. At the state level, deducting their property taxes from their New York income tax returns would save them \$478.84 on their tax bill.

### **State Tax Return Implications of the Elimination of the State and Local Tax Deduction:**

A taxpayer who has itemized their deductions at the federal level may also itemize their deduction when filling out their New York income tax return. An individual must modify the itemized deduction taken at the federal level by excluding any amounts they claimed for state or local income taxes or sales taxes. This leaves the amount paid for real property taxes on a filer's primary residence.

According to the state's latest tax, expenditures report<sup>17</sup>, this ability to deduct property tax cost the state \$716.6 million in 2014 and is estimated to cost \$704 million this tax year, making it the second largest deduction after the mortgage and investment interest deduction at the state level.

According to the last available comprehensive report of income tax filing available<sup>18</sup>, a total of 1.638 million New Yorkers took this itemized deduction in 2014 on their state tax returns. They claimed \$16.2 billion in deductions at the state level, with the average amount of the deduction being \$9,883. **The average actual tax savings was \$437 in 2014, a figure arrived at by dividing the cost of the deduction according to the tax expenditures report by the number of filers who claimed the deduction.**

Section 615 of the tax law, which lays out the rules for claiming the deduction of state and local taxes on one's state return, reads as follows:

*New York itemized deduction of a resident individual. (a) General. If federal taxable income of a resident individual is determined by itemizing deductions from his federal adjusted gross income, he may elect to deduct his New York itemized deduction in lieu of his New York standard deduction. The New York itemized deduction of a resident individual means the total amount of his deductions from federal adjusted gross income, other than federal deductions for personal exemptions, as provided in the laws of the United States for the taxable year, with the modifications specified in this section...*

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<sup>17</sup> <https://www.budget.ny.gov/pubs/executive/eBudget1718/fy18ter/TaxExpenditureFY18.pdf>

<sup>18</sup> [https://www.tax.ny.gov/research/stats/stat\\_pit/personal\\_income\\_tax\\_returns/analysis\\_of\\_2014\\_personal\\_income\\_tax\\_returns.htm](https://www.tax.ny.gov/research/stats/stat_pit/personal_income_tax_returns/analysis_of_2014_personal_income_tax_returns.htm)

New York tax law links the ability to claim the deduction for local taxes in one's state return to the ability to claim the deduction on one's federal return. If Washington were to eliminate the itemized deduction for state and local taxes, then the ability of New Yorkers to claim any part of those taxes on their state return ends as well. **Our state law as currently written would help magnify the negative effects of the elimination of the State and local tax deduction by increasing state tax bills by over \$700 million at the same time that federal tax bills would increase by the billions.**

### **The IDC Legislative Solution:**

In order to prevent New Yorkers from being penalized twice by any possible elimination of the state and local tax deduction on both their federal and state tax returns, the IDC is introducing legislation amending the tax law to prevent the elimination of the deduction at the state level. The new legislation, being introduced in the New York State Senate by Senator David Carlucci, would create a state itemized deduction for real property taxes paid on one's primary residence. This deduction could be claimed only in the event of there being no itemized deduction at the federal level for those same taxes.

Crafting the legislation in this manner makes it clear that the intention is to maintain current state tax policy, which allows individuals to carry over their federal itemized deductions, with some modifications, into their state tax returns. This also means that this legislation is revenue neutral, since it acts to continue current state tax policy in the face of possible negative changes by the Trump administration and Congress. The IDC will work tirelessly to pass this legislation and get it signed into law in order to ensure that our taxpayers are protected.

### **Conclusion:**

The Trump administration is calling for massive changes in federal tax policy, and one of the changes being contemplated seriously in Washington by the President and his Congressional allies is the elimination of the federal itemized deduction for state and local taxes. This deduction, which has existed since the very inception of federal income taxation, is currently claimed by a third of New York taxpayers. If it were to be eliminated, the Independent Democratic Conference estimates that New Yorkers would see their collective tax bill increase by a shocking \$21 billion, or around \$6,474 on average for those New Yorkers that claim the deduction. It is imperative that New York's Congressional representatives take a stand and oppose the elimination of this deduction, regardless of party affiliation.

Unfortunately, any action by Washington to eliminate this itemized deduction would penalize many New Yorkers twice, since the ability of taxpayers to claim an itemized deduction on their New York income tax returns for the real property taxes they pay on their homes is linked by current state law to this federal deduction. If the federal deduction were eliminated, then the ability of taxpayers to claim a deduction on local taxes paid, which is the second largest deduction claimed by New York taxpayers on their state returns, would end as well. Fortunately, this is one negative consequence from the current administration that state legislators have the ability to fix themselves. The IDC is introducing legislation amending our state tax law to preserve this deduction even in the face of negative action by the new administration. This legislation preserves



a tax deduction that saves New Yorkers over \$700 million on their New York income tax returns. Senators Klein and Carlucci and the rest of the IDC will work with our colleagues in state government to ensure that this bill becomes law in order to protect our taxpayers from bad tax policy coming out of Washington.

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<sup>i</sup> <https://labor.ny.gov/stats/lswage2.asp>

<sup>ii</sup> <https://smartasset.com/taxes/income-taxes#nVu4MnodCt>

<sup>iii</sup> <https://smartasset.com/taxes/new-york-property-tax-calculator#bWnswZnbyt>

<sup>iv</sup> <https://labor.ny.gov/stats/lswage2.asp>

<sup>v</sup> <https://smartasset.com/taxes/income-taxes#bncc22kwwz>

<sup>vi</sup> <https://smartasset.com/taxes/new-york-property-tax-calculator#RXG6jxx78a>

<sup>vii</sup> Calculated assuming a 28% marginal tax rate, obtained at <https://smartasset.com/taxes/income-taxes>

<sup>viii</sup> <https://labor.ny.gov/stats/lswage2.asp>

<sup>ix</sup> <https://smartasset.com/taxes/income-taxes#cbF1pT5lqC>

<sup>x</sup> <https://smartasset.com/taxes/new-york-property-tax-calculator#FFUdFP1fnn>

<sup>xi</sup> <https://labor.ny.gov/stats/lswage2.asp>

<sup>xii</sup> <https://smartasset.com/taxes/income-taxes#hGHWxeMFET>

<sup>xiii</sup> <https://smartasset.com/taxes/new-york-property-tax-calculator#bWnswZnbyt>

<sup>xiv</sup> <https://labor.ny.gov/stats/lswage2.asp>

<sup>xv</sup> <https://smartasset.com/taxes/income-taxes#MuezzkbTdo>

<sup>xvi</sup> <https://smartasset.com/taxes/new-york-property-tax-calculator#5kBEodR6C4>

<sup>xvii</sup> <https://labor.ny.gov/stats/lswage2.asp>

<sup>xviii</sup> <https://smartasset.com/taxes/income-taxes#sVGf5sstAL>

<sup>xix</sup> <https://smartasset.com/taxes/new-york-property-tax-calculator#2BtCJuN9eA>