Department of Finance

New York City Council

Committee on Finance

Oversight Hearing
Impact of the Federal Tax Law on New York City

New York City Department of Finance

Testimony of Michael Hyman

First Deputy Commissioner

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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, including for the 4.2 million New Yorkers who benefit from subsidized insurance coverage.

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.