Testimony to

Senate Finance Committee and Assembly Ways and Means Committee

FY 2022 Executive Budget: Taxation

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 more than 2,200 private sector employers across New York, in all major business sectors.

We appreciate this opportunity to share our recommendations and concerns regarding tax provisions in the Executive Budget and other revenue and tax policy proposals being considered by the state legislature. In addition, we will be providing all Senators and Assembly Members with our detailed bill memos on the legislation addressed in today's testimony.

As always, we welcome any additional opportunity to discuss these and other legislative proposals with Committee members and other state legislators, to provide more detailed analysis of key issues, and to answer any questions you may have.

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STATE REVENUE TRENDS AND NEED FOR ADDITIONAL TAX MEASURES -- Any discussion of tax and revenue measures has to start with a consideration of available revenues and revenue targets, including current collection levels, as well as projected spending levels. Our testimony today will focus on revenues and revenue proposals.

Based on the State Comptroller's most recent monthly cash flow report, state revenues have been surprisingly resilient, considering the national COVID-based recession.

The Comptroller's December 2020 cash report shows that, while state tax collections were down slightly comparing the first ten months of Fiscal 2021 to the same period in Fiscal 2020, total state operating fund receipts – i.e., state-imposed taxes and fees that support government operations and aid to localities are in fact up slightly, 0.2% or $194 million, for first 10 months of FY 2021. "Taxes" were down $1.7 billion, but non-tax receipts were up $1.9 billion – and this figure excludes the extra $12.6 billion that the state has already received in federal funds (not counting funds for unemployment insurance benefits.)

Moreover, the gap between the current year and FY 2020 collections has been closing. As example, this past October, personal income taxes receipts were down 6.7 percent compared to October 2020, and consumption tax receipts (primarily the state sales tax) were down by 18.4 percent. In comparison, in January 2021 personal income tax receipts were actually slightly above January 2020 levels (by $34.8 million or 0.1 percent), while the gap in consumption tax receipts had fallen to 11.9 percent.

Importantly, personal income tax receipts were driven by increased estimated payments by high earning New York taxpayers – estimated payments in January 2021 were nearly $1 billion ($968 million) above January 2020 levels. In other words, wealthy New Yorkers who were earning more money paid more in income taxes to the state.

Finally, while the final outcome is still uncertain, it seems likely that Congress will pass and President Biden will sign a $1.9 trillion COVID assistance and recovery bill, with a target approval date of March 14, 2021 – well in advance of the start of the state's fiscal year on April 1. According to information provided by Speaker Pelosi, this package will provide upwards of $50 billion in assistance to New York's state and local governments, a figure that will have a dramatic impact on closing projected budget gaps for state FY 2022. By provisions of the Executive Budget proposal, this increased federal funding would obviate the need for its proposed personal income tax increases.

Based on recent state tax collection trends and pending Congressional actions, we believe that the state should have adequate resources to adopt a balanced budget that addresses major public policy needs for Fiscal 2022, without imposing significant additional tax burdens on individuals or businesses.

At the same time, we recognize the call for further increases in state spending on a wide range of public policy purposes. We believe the best long-term approach to addressing these ever-increasing demands for state spending is renewed and sustained economic growth. Even before the advent of the COVID pandemic, New York City and New York State economic growth was falling behind national levels – indeed, by December 2019 some areas of upstate New York had yet to fully recover jobs lost in the 2009 recession. Now, while some economic sectors are doing well, others continue to deal with significant, extended restrictions on business activity and revenues, and virtually all businesses are operating with increased costs and restrictions driven by necessary COVID protection measures. At a time when New York is competing with other states, and other nations, in its economic recovery, it would be counterproductive to imposes significant permanent increases in tax levies and commit the state to likely unsustainable increases in spending.

EXECUTIVE BUDGET PROPOSALS – The following are our comments on significant revenue and tax policy provision of the Executive Budget.

<u>Pass Through Entity Tax</u> - We strongly support the proposed "pass through entity tax" (S.2509/A.3009, Part C), however, our support comes with several recommended amendments, as detailed below. We support the overall intent of this legislation, which is to restore the full federal deductibility of New York State income taxes imposed on unincorporated businesses such and partnerships and subchapter S corporations, as well as most limited liability companies. Importantly, this is achieved with no loss of tax revenues to New York State (actually, this bill would likely generate a modest increase in state tax receipts.) While we support the intent and basic structure of this proposal, we have several recommended amendments. First, the election should be available to all S-corporations and partnerships, not just those that consist solely of shareholders or partners that are individuals. Second, the bill should apply to all categories of income received by a pass-through entity, not the limited categories authorized in the Executive Budget language. Finally, the bill currently requires an election to be made up fifteen months prior to the date an entity's tax returns are due. We recommend that the state take the approach applied in other states, which allows the election to be made on the entity's tax return.
This legislation will support New York State's small and mid-sized business community at no cost to the state. It restores deductibility of state taxes limited under federal tax reform. And, to date, it is already receiving significant bipartisan support. We urge its adoption as part of the state's FY 2022 budget.

<u>Tax Tribunal</u> - We oppose the proposal to authorize the Department of Taxation and Finance to appeal decisions of the Tax Appeals Tribunal (S.2509/A.3009, Part T.) We believe it will erode the purpose and effect of the Tax Tribunal by subjecting taxpayers to significant, additional litigation costs. Importantly, it would dissuade individual and small business taxpayers from challenging the Department on issues of legitimate dispute and put pressure on taxpayers to settle tax matters where the uncapped litigation costs will far outweigh the tax amount at issue. The Business Council has been a longstanding supporter of the Tribunal, as it provides a straightforward, timely, relatively low-cost mechanism for the review of controversies between the Tax Department and business and individual taxpayers. However, given that the Department already prevails in the vast majority of cases brought to the Tribunal (92 percent of cases receiving a final ruling, in 2019), it is unclear why they should be provided with "another bite at the apple." Further, in recent years, we have seen the Administration include

legislative proposals, including in the Executive Budget, to address recent adverse Tribunal decisions, providing an opportunity for the state to address statutory ambiguities.

Personal Income Tax - We are not taking a position on the proposed five-tier temporary surcharge on personal income taxpayers for tax years 2021 through 2023 (S.2509/A.3009, Part A.) However, we believe that it represents a reasonable, measured approach, designed to produce increased state revenues during a time of expected continued economic slowdown and state revenue shortfall. This proposal would impose a surcharge at a rate of 0.5 percent starting at taxable income of $500,000, increasing in four additional steps to 2 percent for income above $100 million. This proposal includes a mechanism that incentives front-end loading of tax payments in FY 2022, in that it allows taxpayers to pre-pay 2022 and 2023 surcharge liabilities in 2021 and provides a corresponding deduction for these prepayments in 2024. This proposal projects a revenue increase of $1.5 billion in FY 2022, $1.4 billion in FY 2023 and $1.2 billion in FY 2024.

Pandemic Recovery and Restart Program – In general, we are supporting the proposed "Pandemic Recovery and Restart Program" (S.2508/A.3008, Part TT), but continue to work with Business Council members on possible amendments. As introduced, this proposal would provide additional relief to economic sectors most significantly impacted by COVID-related shutdowns. Its "Small Business Return-to-Work Tax Credit Program" provides a refundable tax credit under both the personal income tax and the corporate franchise tax to small businesses in qualifying industries that have experienced a 40 percent or more loss in jobs or revenue. These tax credits are for $5,000 for each full-time job restored, up to $50,000 per taxpayer, with a program cap at $50 million. Likewise, it creates the "Restaurant Return-to-Work Tax Credit Program," for small, independently owned restaurants located in New York City or in areas designated as red or orange zones for at least 30 days. It applies criteria similar to that under the small business credit, and also has total benefits capped at $50 million. We are considering several possible amendments to make this program more responsive to the needs of business sectors most severely impacted by the COVID downturn, focusing on the eligibility criteria, and will be providing you with formal proposals shortly.

Brownfield Tax Credits – We appreciate the Executive Budget's limited extension of eligibility for brownfield redevelopment credits (S.2508/A.3008, Part AA). This proposal allows qualified developers whose projects were adversely impacted by the COVID-19 pandemic an additional two years to complete redevelopment of sites and still qualify for the brownfield redevelopment credit (i.e., the tangible property credit. However, this proposal is only applicable to project whose eligibility expired, or is set to expire, between March 20, 2020 and December 31, 2021. More needs to be done to preserve this program that has proven to be both effective, and cost-effective, in bringing contaminated property back to productive economic use. Provisions adopted in 2015 (Chapter 56, Laws of 2015, Part BB, Section 31) precludes brownfield redevelopment credits for any project "accepted" into the program after December 31, 2022, and for any project accepted into the program on or after July 1, 2015, it precludes brownfield redevelopment credits if the project does not receive its certificate of [cleanup] completion by March 31, 2026. Given approval delays and construction project delays caused by the COVID pandemic, we believe these timetables should be extended. Moreover, we believe legislature should work on a long-term extension of the brownfield program to assure continuation of this important property reclamation program. We are working with brownfield development interests on a formal proposal, which will be presented to the legislature within the next several days.

Child Care Incentive – We are supporting the proposed amendments to the state's existing child care credit for employer-provided day care services (S.2509/A/3009, Part D.) We recognize New Yorker's growing challenge in securing quality, affordable childcare services – challenges that have been exacerbated by the COVID crisis. At the same time, employers are increasingly looking for opportunities to assist employees in meeting this critical need. Toward this end, we support this legislation that has two main components. First, it makes certain childcare program capital and operating expenses eligible for incentives under the Excelsior jobs program (noting that the Excelsior tax credit program is not "as of right," but needs to be applied for, and total credits are subject to an annual cap.) The second component increases the existing state childcare credit to 200 percent of the credit allowed under the federal credit set forth in IRC Section 45F (i.e., a credit of 50 percent of qualifying expenditures, rather than 25 percent under current law), and an increase in the maximum annual per taxpayer credit to $500,000, up from $150,000 under current law. While our members appreciate the current credit, it does not address the increasing costs of providing childcare, nor the growing demand for childcare service from employers. We believe this legislation will help address both concerns.

<u>Permanent County and City Sales Tax Rates</u> – While not a direct issue for our members, we support the Executive Budget proposal to permanently extend existing authority for counties and cities to impose sales tax rates at their current rates (S.2509/A.3009, Part L.) These entity-specific provisions are routinely extended by the legislature, and we cannot think of a recent instance where such rates were allowed to expire or were reduced. This legislation would provide revenue certainty to municipalities at a time when they are seeing, in some cases, significant reductions in local tax receipts.

<u>Treatment of Federal Sub-S Corporations</u> – We oppose the Executive Budget provision (S.2509/A.3009, Part E) that would eliminate the state's "sub-S" election and mandate that all Federal subchapter S corporations be treated as subchapter S corporations under state tax law. We appreciate the Department's concerns regarding limited instances of tax avoidance schemes involving the sub-S election, but we believe those instances can be addressed under existing tax fraud and false claims act provisions, or through more limited amendments to the Commissioner's authority. We believe that small business taxpayers should be allowed the continued flexibility as provided under current state law.

THE PENDING $10 BILLION+ TAX INCREASE ON NEW YORK EMPLOYERS – In considering proposed tax increases on New York State employers, the legislature needs to recognize that employers are already facing a near certain tax increase of $10 billion or more, which will start impacting the state's employers in 2021 and will be felt for years beyond. As of December 31, 2020, New York State's unemployment insurance program had already borrowed $9.42 billion from the federal government, as the payment of state-level UI benefits to unemployed New Yorkers far outpaced the program's revenues. The unemployment insurance program is 100 percent financed through taxes imposed on employers' payroll, and – under current law – those federal advances will be repaid through increased state and, ultimately, federal employer taxes. While the federal CARES act provided billions in enhanced and expanded unemployment insurance benefits to many New Yorkers, that infusion of federal funds did not help pay for "regular" employer tax-supported UI benefit payments. To date, federal relief has been limited to a suspension of interest of federal advances. Some have called for federal financial support for state's unemployment insurance programs as part of federal pandemic relief legislation, but no such assistance has yet materialized. Likewise, with New York State facing its own budget challenges, state assistance is unlikely as well. New York already has taken an important first step in alleviating the immediate impact by suspending "experience rating" in setting employer-specific unemployment insurance tax rates for 2021. This means that employer-specific UI tax rates for 2021 will not be impacted by COVID-related layoffs. At a time when many businesses are seeing reduced sales due to COVID, this action minimizes immediate unemployment insurance tax hikes. Second, even more important, the state needs to avoid imposing additional costs, restrictions and mandates on businesses still struggling to deal with the COVID-induced recession. New York State's focus for 2021 should be on ways to help businesses stay in businesses, to promote the retention and creation of good paying jobs, and to position the state for a strong post-COVID economic recovery.

OTHER TAX LEGISLATION – The state legislature has introduced hundreds of additional proposals amending the state Tax Law that would impose significant additional tax burdens on New York businesses and residents. As we expect that a number of these proposals are being considered for inclusion in the Senate and Assembly budget proposals, it is important that we include several of them in our budget testimony. These include:

Filing Deadlines – We will be sharing with the legislature a proposal to extend corporate income tax filing deadlines to a date at least one month after the federal extended filing deadline of October 15. State returns are based on federal returns and cannot in practice be completed until the federal return has been filed. This concern was exacerbated in FY 2017 when Congress changed the extended federal corporate filing deadline to October 15, which results in many extended state corporate returns having the same due date. The issue is particularly problematic given the complexity surrounding state conformity to the federal TCJA of 2017 and CARES Act of 2020. Under current state law, an Article 9-A taxpayer is required to file their return by April 15, but is eligible for an automatic extension of six months – until October 15, the new federal filing deadline (provided that the taxpayer pays on or before the filing deadline their "properly estimated" taxes.) Extending this deadline – or, at minimum, extending the date for the automatic filing extension – until November 15 would both enhance the accuracy of state returns filed by taxpayers and ease the administrative burdens imposed on tax administrators by reducing the number of amended returns filed due to the concurrent federal and state filing deadlines.

Corporate Franchise Tax - We strongly oppose S.2833 (Hoylman)/A.4595 (Kelles), which would impose an additional state corporate franchise tax levy equal to the difference between the federal corporate income tax rate effective in 2017 (35 percent) and the lower rate (21 percent) adopted by the federal "Tax Cuts and Jobs Act of 2017." This legislation also imposes an additional levy under the personal income tax on any pass-through business income deducted under IRC Section 199A, also adopted as part of TCJA, at a rate equal to the federal personal income tax rate that would apply to such taxpayer (with an exemption for certain small businesses). The sponsors' revenue projection is $9 billion annually. While the estimate does not break out revenues by tax code article, it would result in a more than doubling of the state's corporate franchise tax rate and receipts. We believe this would have a disastrous impact on the state's business climate and economic recovery efforts. New York's current corporate franchise tax rate is fairly competitive, at "only" the twenty-first highest among the states. But the corporate franchise tax is not the only tax paid by employers, and data shows that the combined state and local tax burden on New York businesses is high. According to research by the Council on State Taxation (a national organization that focuses on state tax policy, but does not lobby on state tax rates), New York already imposes more total state and local taxes on business than any state but California – more than Texas, and nearly double the total burden imposed in Florida; New York's total effective business tax rate is 25 percent above the national average; and its business tax levies per employee are 60 percent above the national average. Moreover, it makes no sense to impose a tax penalty on New York business taxpayers based on concerns about provisions of federal tax law (we note that President Biden has announced his intention to increase the federal corporate tax rate to 28 percent.) As a final issue, the legislature should recognize that corporate profits are tax a second time when paid as dividends to shareholders, and these payments are subject to New York's already high personal income tax rates.

Stock Transfer Tax/Financial Transaction Tax - We oppose this legislation -- S.1406 (Sanders)/A.3352 (Steck) -- that repeals the rebate for stock transfer taxes paid, with a revenue estimate of up to $13 billion annually. We oppose this legislation for a number of reasons. It would impose a massive, disproportionate tax on a narrowly defined industry (at the sponsor's estimated revenue level, this would hit the financial services industry with a new tax burden that is higher than that imposed under the six largest state and New York City business taxes combined.) It would have a significant adverse impact on a key sector of New York State's economy that is already feeling the effect of increasing state and foreign competition. The tax is imposed on stock transactions that occur within New York State, and with expanded use of technology, this tax can be easily avoided, to the detriment of the state's economy (As example, a recent Bloomberg Technology report showed that only 33 percent of U.S equity trades were executed on the NYSE or NASDAQ in December 2020, as off-exchange trading has "surged," accounting for 47 percent or more of the U.S. stock market, up from 40 percent in 2019.) A trade by a non-New York resident can be done on-line with the trade electronically completed by entities and on servers located outside of New York State. A stock transfer tax would be a financial incentive for investors to avoid New York-based brokers, advisors and exchanges. Finally, a financial transaction tax would also impose a tax on retirement savings, including public and private pensions, individual retirement funds, and others. Even if legislation exempted some of these entities from the tax, it would be difficult if not impossible to fully insulate them from adverse tax impacts (e.g., pension fund investments in mutual funds and similar investment vehicles.)

Data/Digital Product Taxes – There are several proposals to impose new taxes on "technology" companies and their use of customer data. Current proposals in New York include: S.302 (Thomas)/A.734 (Rosenthal) which would extend the state's sales and use tax to advertising services provided on a "digital interface;" S.1124 (Gianaris) which would adopt a new Article 15 of the Tax Law to impose a tax on any person or entity's "gross revenues derive[d] from digital advertising services in the state;" and S.3790 (Comrie)/A.2195 (Aubry) which would create a new tax mechanism under the corporate franchise tax to impose a separate, additional five percent tax on corporation's "gross income" that is "derived from" the "data [which] individuals of this state share with such." Each of these proposals suffers from the same fatal flaw – they are inconsistent with the federal Internet Tax Freedom Act (ITFA), P.L. 105-277 which prohibits state and local governments from imposing discriminatory taxes on electronic commerce, i.e., it prohibits taxes on a good, service, or information delivered electronically that would differ from the tax or rate applied to the same, or similar, good, service, or information if it were purchased through traditional commerce. Its prohibition on discriminatory taxes applies to taxes on the income derived from such goods, services and information. Since these bills impose an additional, separate tax on income earned from the sales of a digital service, that is not similarly applied to other similar categories of advertising services, they would impose a discriminatory tax that is prohibited under the ITFA. We note that Maryland's first in the nation digital advertising tax – adopted over their Governor's veto and against the recommendations of the state's Attorney General – is already subject to (likely successful) legal challenge.

"INVEST IN NEW YORK" - Legislators are hearing from the "Invest in New York" campaign, which is endorsing six proposals to raise upwards of $50 billion in increased annual state taxes, compared to estimated FY 2020 all funds tax receipts of $82.9 billion. That organization is further proposing to dedicate those increased revenues to permanent increases in spending on a wide range of programs including Medicaid, housing, primary and secondary education, SUNY and CUNY, and others. We would like to offer the following comments on their revenue proposals.

Personal income tax – They are endorsing S.2622 (Jackson)/A.4604 (Meeks), one of a number of personal income tax increase bills introduced so far in the 2021 legislative session. This legislation applies the current 6.85% rate to income between $323,200 and $1 million; repeals the current 8.82% rate and bracket; applies a rate of 9.62% for $1 to $5 million; 10.32% for $5 to $10 million; 11.32% for $10 to $100 million; and 11.82% for over $100 million. Its estimated annual revenue increase is $4.3 billion. We oppose this proposal which would catapult New York into second place for the highest marginal personal income tax rate of any state, second only to California at 13.3 percent, bypassing Hawaii (11.0%), New Jersey (10.75%), Oregon (9.9%) and Minnesota (9.85%). However, residents of New York City would see the highest marginal combined state and local personal income taxes in the U.S., at 15.7 percent. The "Invest in New York" website says this legislation "creates an equitable tax system where New Yorkers pay a higher rate if they earn significantly more money." This is a somewhat disingenuous statement as it ignores the fact that New York's personal income tax is already steeply progressive. The top 1 percent of earners (measured by adjusted gross income) pay 43.5 percent of all personal income tax (the lowest 40 percent of taxpayers by AGI have negative income tax liability), and their effective tax rate is more than three times greater than a taxpayer at the 50th percentile AGI (actually, it is 354 percent of the 50th percentile effective tax rate.)

"Heirs Tax" – Their organization supports S.3462 (Brisport)/ A.4643 (Solages). We have not yet taken a formal position on this legislation, but we would raise several significant concerns. First, for a state already widely considered as one of the most expensive in which to retire, the higher estate tax rates and newly imposed heirs' tax included in this proposal would make New York even more of an outlier among states (as shown by the Tax Foundation and others, only 12 states have an inheritance tax, only six – including New York - have an estate tax, and only one – Maryland – has both) and would provide another incentive for the out-migration of retirement-aged New Yorkers. For the largest estates, this bill would impose a marginal tax rate of 50 percent – more than double the top marginal rate imposed under any state's estate tax. This would be a major incentive for such taxpayers to end their New York residency. Second, we are concerned about the impact that this bill will have on small family-owned businesses. For an estate valued at less than $5 million, if its business assets are less than half of the estate's value, those assets will be subject to the newly imposed heirs' tax. If the business assets are more than half of the value of an estate valued at less than $5 million, the inheritance tax can be deferred, but that deferred tax liability will incur interest until the date the assets are sold. This tax on small business will apply to estates valued as low as $250,000, and while the tax liability may appear modest, it is applied without regard to the profitability of the business. If nothing else, we believe that if small business assets are not exempted from this legislation, the bill's applicability thresholds for business assets should be increased.

<u>Capital Gains Tax</u> – That organization supports S.2522 (Rivera)/A.3352 (Kim) which imposes increased personal income tax levy on a taxpayer's capital gains investment income, despite the fact that, unlike the Internal Revenue Code, <u>New York State currently does not apply lower income tax rates to capital gains</u>. The bill purports to be "correcting the unfair federal tax benefit for income earned from investing rather than working. Said another way, this legislation imposes a tax penalty on New York State taxpayers due to perceived inequities in federal tax law. We believe this is simply bad tax policy, and we oppose its' adoption.

<u>Financial Transaction Tax</u> – We have already addressed our concerns of adverse economic and fiscal impacts of a reimposed stock transfer tax. The Invest in New York organization is endorsing S.3980 (Salazar)/A.5210 (Niou), which creates a new tax on a wider range of financial transactions, including corporate stock; partnerships or beneficial ownership interest in a partnership or trust; any note, bond, debenture, or other evidence of indebtedness, other than a state or local bond; any derivative financial instrument with respect to any currency or commodity including notional principal contracts; and any other derivative financial instrument including any option, forward contract, futures contract, notional principal contract, or any similar financial instrument. Its revenue estimates are up to $29 billion annually. We oppose this legislation for the same reasons discussed early.

<u>Mark to Market Tax</u> – The most aggressive of the group's legislative recommendations is S.4482 (Ramos)/A.5092 (De La Rosa), which would impose a tax on the "mark to market" value of most assets of New York residents with a net worth of $1 billion or more. It estimates an initial revenue gain of $23 billion in its first year's applicability, and recurring annual revenues of $1.2 billion. The sponsors apparently recognize that the New York State Constitution currently presents at least two bars to this legislation – Article 16, Section 3 prohibits both the *ad valorem* taxation of intangible property and the taxation of undistributed profits. The Senate sponsor has proposed legislation, S.4699, that would repeal this provision of the Constitutional amendment. Our only comment on this legislation at this time is that the state's process for amending its Constitution will provide potentially affected taxpayers ample opportunity to consider and respond to its potential impact.

Finally, the organization endorses a dramatic increase in corporate franchise tax rates, proposed in S.2833 (Hoylman)/A.4595 (Kelles), which is addressed above.

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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