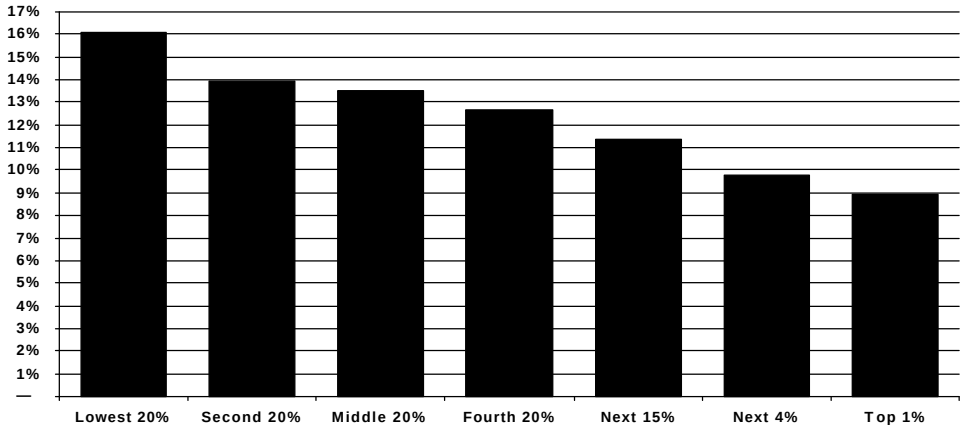
# Personal Income Tax Changes in New York State: Enacted 1995 Cuts and Proposed 2003 Cuts

Institute on Taxation and Economic Policy, February 1999

In 1996, the Institute on Taxation and Economic Policy released a report entitled *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*.[1] In that study, we found that, in 1995, New York had a regressive tax structure—that middle- and low-income New Yorkers paid a higher share of income in New York state and local taxes than did the better-off.

**New York Taxes as a Share of Income, 1995**




Source: Institute on Taxation and Economic Policy and Citizens for Tax Justice, 1996.
Data are for nonelderly married couples in 1995, after federal offset.

Since the beginning of 1995, a series of tax changes have been enacted that are reducing New York State tax collections by several billions of dollars per year. One question which has not been adequately examined in this tax-cutting period has been the extent to which these tax cuts have, or have not, improved the equity of New York's tax structure.

[1]Who Pays? A Distributional Analysis of the Tax Systems in All 50 States. Ettlinger, O'Hare, McIntyre, King, Fray and Miransky (Institute on Taxation and Economic Policy and Citizens for Tax Justice, 1996). The study is available from ITEP and can be found on the Internet at www.ctj.org/ITEP.

In addition, more tax cuts appear to be in the offing. This analysis examines the current effect of the largest single tax cut since 1994, the personal income tax changes enacted as part of the 1995 budget, and the further changes in the income tax that have recently been proposed by Governor Pataki. The Institute on Taxation and Economic Policy Microsimulation Tax Model is used to calculate the impact on different income groups of these tax law changes and proposals (see Appendix for a description).

## The 1995 Tax Cuts

### What This Analysis Compares

Our approach is to compare two snapshots of the New York tax structure. One snapshot is of the personal income tax law as it existed in 1998 (which is, for the most part, the same as for 1999). We compare this to the law as it existed in 1994. The differences between the 1994 and 1998 laws are broken down between the impact of the close to four billion dollars in lower taxes for residents of New York as a result of the 1995 tax cuts and the impact of the 1994 Earned Income Tax Credit legislation which is now approaching $400 million in total. Other, less significant changes in the New York personal income tax over this period are disregarded for purposes of this analysis.

This analysis does not show the impact of changes to laws that had never gone into effect. Specifically, the repeal, in 1995, of the 1987 tax law passed under Governor Cuomo is not included.

The full implementation of the 1987 tax cuts, passed in response to federal tax reform in 1986 during the Reagan Presidency, had been frequently postponed and long delayed. The original rationale for passage of the 1987 legislation is not significantly relevant currently, and at the time of the 1995 budget's passage the implementation of the 1987 cuts had been "frozen" since 1989.[2] Thus, treating the 1987 legislation as living law, scheduled to go into effect, would have been speculative, even if technically justifiable. As stated above, instead of comparing 1998 taxes to what would have been the law if the 1987 law had been allowed to go into effect, we compare 1998 taxes to what they actually were in 1994 with the 1987 act treated as dead-letter law.

### Tax Changes in the Fiscal 1995 Budget Agreement

The personal income tax changes in the 1995 budget bill were significant. All but one of the tax rates (the bottom one) were lowered and tax brackets were widened. Standard deductions were increased, with the deduction for joint filers going from $9,500 to $13,000. The phase-in of the Earned Income Tax Credit (the EITC had previously been enacted under

[2]The 1987 legislation was originally scheduled to phase-in completely by 1990. But budgetary constraints forced the legislature to halt the phase-in of the cuts in 1989, and this "freeze" was repeated every year until the passage of the 1995 legislation.

Governor Cuomo) was accelerated to be completed in 1996 instead of 1997.[3] The EITC was, however, cut in the long term. The law was changed so that the Earned Income Tax Credit is reduced by the amount of Household Credit actually used by a taxpayer.[4] The table below summarizes the impact, in 1998, of the 1995 budget's personal income tax changes. These changes reduce state income tax payments by New York State residents by about four billion dollars in 1998 (non-residents enjoy a tax cut of hundreds of million dollars as well, but this analysis only examines the impact on residents). This translates into an average tax cut of $434 for New Yorkers. This aggregate result, however, masks considerable variation by income levels. For example:

**1995 Income Tax Tax Cuts In Effect 1998**

- Rate reduction
- Some Stretching of Brackets
- Standard Deduction Hike
- EITC reduced by Household Credit

- The poorest New Yorkers, those who currently have the highest tax burden in the state when all taxes, not just the income tax, are taken into consideration, were excluded almost entirely from the 1995 tax cuts. The poorest twenty percent of New Yorkers, on average, found their personal income tax burden reduced by an average of $8.
- While the second twenty percent of New York residents received, on average, a net tax reduction of $68 in 1998 due to the 1995 tax cuts, this cut represented only three percent of the total 1995 income tax cuts.
- Most of the 1995 cuts—65 percent of the total income tax cut—went to the best-off twenty percent of the income distribution in 1998.
- A full 24 percent of the tax cuts went to only the wealthiest one percent of New Yorkers—those with incomes exceeding $494,000 and with an average annual income of $1.3 million. This group received an average tax reduction of over $11,000.

## 1995 Tax Cut Effect by Income Class in 1998

| Income Group | Lowest 20% | Second 20% | Middle 20% | Fourth 20% | Top 20% | | |
|---|---|---|---|---|---|---|---|
| | | | | | Next 15% | Next 4% | Top 1% |
| Average Income in Group | $7,400 | $16,800 | $28,900 | $48,500 | $85,700 | $189,100 | $1,278,500 |
| Income Range | Less than $12,000 | $12,000 – $22,000 | $22,000 – $37,000 | $37,000 – $63,000 | $63,000 – $130,000 | $130,000 – $494,000 | $494,000 – or more |
| Tax Cuts as % of Income | –0.1% | –0.4% | –0.8% | –1.0% | –0.9% | –0.8% | –0.9% |
| Average Tax Cut | $ (8) | $ (68) | $ (236) | $ (461) | $ (796) | $ (1,482) | $ (11,028) |
| Share of Total Tax Cut | 0% | 3% | 11% | 21% | 27% | 14% | 24% |

**Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, February 5, 1999.**

[3]The EITC is a credit on the federal tax return available to low-income people with earned income. It is a refundable credit, meaning that if the credit exceeds before-credit tax liability the excess is paid to the filer.

[4]The Household Credit is a non-refundable New York State credit for taxpayers with income below $32,000.

**Why so Little for Low-Income Families?**

The primary reason that the lowest income New Yorkers received so little of these tax cuts is that they weren't paying very much in personal income tax to start with. The personal income tax is New York's one major progressive tax. Better-off people pay more personal income tax than do less-well-off people.

This isn't to say that lower income families don't pay taxes. As the distributional table at the beginning of this report shows, the burden in New York on low-income families is higher than on any other group. But, it is regressive consumption taxes (sales taxes, gas taxes, etc.) and property taxes that hit them the hardest. The choice of the income tax as the tax to cut in 1995 almost guaranteed that low-income families would get very little.

The one aspect of the 1995 legislation that was targeted at low-income families was the acceleration of the phase-in of the EITC. The 1994 EITC legislation called for the credit to start at 7.5 percent of the federal credit in 1994, go to 10 percent in 1995, 15 percent in 1996 and end up at 20 percent for 1997 and subsequent years. The 1995 tax cut merely increased the credit to the full twenty-percent a year early—in 1996.

**The Impact of Rate Reduction and Standard Deduction Increases on New Yorkers**

The two principal tax-cutting mechanisms used in the 1995 budget's personal income tax provisions were a reduction in tax rates and an increase in the state's standard deduction.

The chart at right compares the bracket structure for married filers before and after the implementation of the 1995 budget agreement. All rates are lowered except the bottom rate. Note, that this is a taxable income table. Thus, a married couple would have to have at least the bottom bracket amount plus the standard deduction ($24,000) to benefit from these rate cuts. Above the bottom bracket, however, the combination of the lower rates and the broadening brackets (which causes more income to be taxed at lower rates) cuts taxes for everybody else.

| Change in Nominal Tax Rates, Joint Filers | | |
|---|---|---|
| **Taxable Income** | **1994 Rates** | **Current Rates** |
| Under $11,000 | 4.00% | 4.00% |
| $11-16,000 | 5.00% | 4.00% |
| $16-22,000 | 6.00% | 4.50% |
| $22-26,000 | 7.00% | 5.25% |
| $26-$40,000 | 7.875% | 5.90% |
| Over $40,000 | 7.875% | 6.85% |

The 1995 legislation also increased standard deductions significantly, with single filers seeing an increase from $6,000 to $7,500 and joint filers from $9,500 to $13,000.

**1995 Tax Changes and the Earned Income Tax Credit**

While the 1995 legislation increased the value of the EITC for taxpayers in 1996, this acceleration represented a one-time tax cut for those claiming the credit. It has no effect on 1998 tax liability.

The only lasting consequence of the 1995 legislation for EITC recipients, in fact, is the creation of a linkage between the Household Credit and the Earned Income Tax Credit—a linkage which has the effect of *reducing* the value of the EITC credit in 1998. Before the passage of the 1995 budget legislation, the value of the EITC to eligible residents was not reduced by the value of other credits received. But the 1995 legislation included a provision

that required EITC applicants to subtract from the EITC credit the amount of Household Credit for which they were eligible.[5]

## The Impact of EITC Implementation Since 1994

The distinction between tax changes *enacted* since 1995 and tax changes *implemented* since 1995 is of particular importance in analyses of the New York Earned Income Tax Credit. The enactment of the New York EITC in 1994 provided substantial tax reductions to low-income working New Yorkers to be phased-in over several years, culminating in a credit equal to 20 percent of the equivalent federal credit. The total amount of New York EITC increased by more than $150 million between 1995 and 1996, from $137 to $291 million. This change is largely attributable to the final step of of the EITC phase-in.

Full implementation of the EITC had a significant effect upon the credit amount for low-income New York residents—more than doubling the average credit as it rose from 7.5 percent of the federal credit in 1994 to 20 percent in 1996. Some previous analyses of the distributional impact of the 1995 legislation have included the full amount of the EITC and implied that it was due to the legislation. Such an approach, however, does not correctly show the impact of the legislative activity from 1994 to 1998 on EITC benefits. While EITC recipients received an average of $175 more under the fully phased-in EITC than they would have if the 1994 EITC calculation remained in force today, *none* of this gain is due to the 1995 budget's tax changes. In fact, EITC recipients would receive slightly more from the EITC credit if the 1995 changes had not been enacted.

**1994 EITC Increase and 1995 Income Tax Cut Effect by Income Group in 1998**

| Income Group | Lowest 20% | Second 20% | Middle 20% | Fourth 20% | Top 20% | | |
|---|---|---|---|---|---|---|---|
| | | | | | Next 15% | Next 4% | Top 1% |
| Average Income in Group | $7,400 | $16,800 | $28,900 | $48,500 | $85,700 | $189,100 | $1,278,500 |
| Income Range | Less than $12,000 | $12,000 – $22,000 | $22,000 – $37,000 | $37,000 – $63,000 | $63,000 – $130,000 | $130,000 – $494,000 | $494,000 – or more |
| **Total Tax Change as % of Inc.** | **–0.9%** | **–1.1%** | **–0.9%** | **–1.0%** | **–0.9%** | **–0.8%** | **–0.9%** |
| EITC Only | –0.8% | –0.7% | –0.1% | –0.0% | — | — | — |
| 1995 Tax Changes | –0.1% | –0.4% | –0.8% | –1.0% | –0.9% | –0.8% | –0.9% |
| **Total Average Tax Change** | **$ –69** | **$ –183** | **$ –261** | **$ –467** | **$ –796** | **$ –1,482** | **$ –11,028** |
| EITC Only | $ –61 | $ –115 | $ –25 | $ –6 | $ — | $ — | $ — |
| 1995 Tax Changes | $ –8 | $ –68 | $ –236 | $ –461 | $ –796 | $ –1,482 | $ –11,028 |
| **Share of Total Tax Cut** | **3%** | **8%** | **11%** | **19%** | **25%** | **12%** | **22%** |

**Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, February 5, 1999.**

[5]The point is sometimes made that if the 1987 law had been allowed to go into effect, the household credit would have been eliminated anyway so EITC recipients didn't lose anything. This, of course, is not necessarily a reason to single out EITC recipients. And many other aspects of the tax law would have been different had the 1987 legislation gone into effect. But it had been postponed regularly from 1989 on and ultimately was repealed.

## Personal Income Tax Provisions of the Governor's 1999 Tax Cut Proposal

Governor Pataki recently unveiled his proposed fiscal year 1999-2000 Executive Budget. Among the tax changes proposed in the budget are several cuts in the personal income tax, including an increase in the state's dependent exemption from $1,000 to $2,000 and an increase in the income levels at which the top marginal rate of 6.85 percent applies to taxable income. The proposed changes would be phased in over a two-year period between 2002 and 2003. The distributional consequences of the proposed changes are similar to those of the 1995 budget in that they fail to reduce taxes for those currently facing the highest tax burden. In particular:

**1999 Income Tax Cut Proposals**
**Fully implemented at 1998 levels**

| Income Group | Tax cut as a % of income | Average Tax Change | Percent of total cut |
|---|---|---|---|
| **Lowest 20%** | 0.0% | (0) | 0% |
| **Second 20%** | -0.1% | (9) | 3% |
| **Middle 20%** | -0.1% | (29) | 11% |
| **Fourth 20%** | -0.2% | (74) | 28% |
| **Next 15%** | -0.2% | (180) | 50% |
| **Next 4%** | 0.0% | (91) | 7% |
| **Top 1%** | 0.0% | (48) | 1% |
| **ALL** | -0.1% | (53) | 100% |

- The poorest twenty percent of New York residents would see, on average, a few cents reduction in tax from the 1999 tax cut proposal. The second twenty percent of taxpayers would see an average tax cut of $9 if the proposed cuts were enacted.
- The wealthiest twenty percent of New Yorkers would receive 58 percent of the benefits of these cuts.
- The bottom sixty percent of New York residents would receive only 14 percent.

**Proposed Tax Bracket Changes, Joint Filers**

| Rates | 1998 Brackets | 2003 Brackets |
|---|---|---|
| 4.0% | 0-$16,000 | 0-$16,000 |
| 4.5% | $16-22,000 | $16-22,000 |
| 5.25% | $22-26,000 | $22-26,000 |
| 5.9% | $26-40,000 | $26-$60,000 |
| 6.85% | > $40,000 | >$60,000 |

The magnitude of these cuts is clearly smaller than the cuts enacted in the 1995 budget legislation: hundreds of millions instead of billions of dollars and much smaller average tax cuts. But the targeting of the cuts away from lower income taxpayers continues.

## Analysis of Individual Provisions of Proposed Cuts

Of the proposed budget's two income tax cuts, the personal exemption increase is the more important source of tax relief for middle-income New Yorkers. The middle twenty percent of the New York income distribution—those residents earning between $22,000 and $37,000 in 1998—would receive an average tax

**Disaggregating the Pataki cut's effect:**

| Income Group | Personal Exemption | | Brackets Widened | |
|---|---|---|---|---|
| | Average Tax Cut | % of Total Cut | Average Tax Cut | % of Total Cut |
| **Lowest 20%** | $ (0) | 0% | $ - | 0% |
| **Second 20%** | $ (9) | 6% | $ (0) | 0% |
| **Middle 20%** | $ (22) | 16% | $ (7) | 6% |
| **Fourth 20%** | $ (43) | 32% | $ (33) | 24% |
| **Next 15%** | $ (63) | 35% | $ (120) | 66% |
| **Next 4%** | $ (65) | 9% | $ (27) | 4% |
| **Top 1%** | $ (48) | 2% | $ (0) | 0% |

cut of $22 from the proposed exemption increase taken in isolation. Conversely, the widening of the top tax bracket provides almost no tax cut for the lowest income sixty percent of New York taxpayers. Seventy percent of the tax cut due to the broadening of the top tax bracket accrues to the best-off 20 percent of New Yorkers.

## Other Tax Cuts of the Mid- to Late 1990s

While the 1995 personal income tax cuts represent the largest single tax cut enacted since 1995, other tax changes of note have been legislated in recent years. Corporate tax reductions enacted in 1998 will reduce collections by over $400 million when fully effective, and recently enacted cuts in the state's estate tax have been estimated to cost $440 million. Finally, a series of temporary sales tax exemptions for clothing purchases, combined with the permanent exemption of clothing purchases of less than $110, effective in December of 1999, will reduce sales tax collections by close to $500 million.

In addition, earlier corporate income tax cuts have become fully effective in recent years, the STAR property tax cuts will be phased in over the next several years and there have been other, relatively small tax cuts.

The distributional impact of these changes will be mixed. The clothing exemption will benefit the less well-off more than the wealthy. The estate tax cut, on the other hand, helps the well-off the most, as do corporate income tax cuts. Also, compared to the income tax cuts analyzed here, the clothing exemption is small.

The STAR plan cannot be so easily characterized. It is a substantial tax cut, although still much less than the income tax cuts. Homestead exemptions such as in the STAR plan typically benefit those with lower value homes more than those with higher value homes. And, even though renters are excluded from the benefit, homestead exemptions usually have a mildly progressive impact. But STAR is designed in such a way as to minimize its progressivity. In particular, the homestead exemptions are higher in areas with more valuable homes.

In addition, because STAR is state funded, the level of progressivity depends on how the taxes to pay for it are raised. Particularly if state personal income taxes continue to be cut, the load will be carried by less progressive taxes and the net impact could be regressive. Thus, while a locally adopted homestead exemption paid for by higher overall property tax rates clearly shifts tax burden from those with lower valued homes to those with higher valued homes and businesses, this is not necessarily true of a state funded homestead exemption.

Overall, it is likely that STAR, given the funding by the state, exclusion of renters and the favoring of wealthier areas, is minimally progressive at best.

STAR is not targeted at those with the highest tax burdens under the current system. There is little about it designed to give relief to those who need it the most. Another approach to property tax relief that is relatively common is called a "circuit breaker." Circuit breakers typically cap property taxes at a percent of homeowner's income. Thus, those who face higher property tax burdens relative to their income get a greater benefit. Also, circuit breakers often are available to renters. Typically, a percentage of rent is assumed to be the amount of property tax passed through by landlords in higher rent. The percentage is usually

in the 15 to 30 percent of rent range. Even within the STAR homestead exemption framework, the benefits could be more carefully targeted by making the benefits associated with homeowners' income.

## Conclusion

Despite facing the highest tax burdens relative to income, lower- and moderate-income New Yorkers have received disproportionately little of the tax relief legislated from 1995 to the present. Only a modest share of the benefits from the massive tax cuts included in the 1995 budget or proposed in the 2003 cuts have gone, or would go, to this group. Thus, although they may well face as large a share as other New Yorkers in long-term reduction in government services caused by tax cuts—middle- and low-income families have not gotten their full share of the benefit of reduced tax payments.

*This analysis was conducted with the cooperation of the Fiscal Policy Institute, a nonprofit research organization that works on New York State tax and budget issues.*

## ITEP METHODOLOGY

The Institute on Taxation & Economic Policy has engaged in research on tax issues since 1980, with a focus on the distributional consequences of both current law and proposed changes. ITEP's research has often been used by other private groups in their work, and ITEP is frequently consulted by government estimators in performing their official analyses. Over the past several years, ITEP has built a microsimulation model of the tax systems of the U.S. government and of all 50 states and the District of Columbia.

**What the ITEP Model Does**

The ITEP model is a tool for calculating revenue yield and incidence, by income group, of federal, state and local taxes. It calculates revenue yield for current tax law and proposed amendments to current law. Separate incidence analyses can be done for categories of taxpayers specified by marital status, the presence of children and age.

In computing its estimates, the ITEP model relies on one of the largest databases of tax returns and supplementary data in existence, encompassing close to three quarters of a million records. To forecast revenues and incidence, the model relies on government or other widely respected economic projections.

The ITEP model's federal tax calculations are very similar to those produced by the congressional Joint Committee on Taxation, the U.S. Treasury Department and the Congressional Budget Office (although each of these four models differs in varying degrees as to how the results are presented). The ITEP model, however, adds state-by-state estimating capabilities not found in those government models.

Below is an outline of each area of the ITEP model and what its capabilities are:

*The Personal Income Tax Model* analyzes the revenue and incidence of current federal and state personal income taxes and amendment options including changes in:

- rates—including special rates on capital gains,
- inclusion or exclusion of various types of income,
- inclusion or exclusion of all federal and state adjustments,
- exemption amounts and a broad variety of exemption types and, if relevant, phase-out methods,
- standard deduction amounts and a broad variety of standard deduction types and phase-outs,
- itemized deductions and deduction phase-outs, and
- credits, such as earned-income and child-care credits.

*The Consumption Tax Model* analyzes the revenue yield and incidence of current sales and excise taxes. It also has the capacity to analyze the revenue and incidence implications of a broad range of base and rate changes in general sales taxes, special sales taxes, gasoline excise taxes and tobacco excise taxes. There are more than 250 base items available to amend in the model, reflecting, for example, sales tax base differences among states and most possible changes that might occur.

*The Property Tax Model* analyzes revenue yield and incidence of current state and local property taxes. It can also analyze the revenue and incidence impacts of statewide policy

changes in property tax—including the effect of circuit breakers, homestead exemptions, and rate and assessment caps.

*The Corporate Income Tax Model* analyzes revenue yield and incidence of current corporate income tax law, possible rate changes and certain base changes.

**Local taxes:** The model can analyze the statewide revenue and incidence of aggregate local taxes (not, however, broken down by individual localities).

**Addendum: Data Sources**

The ITEP model is a "microsimulation model." That is, it works on a very large stratified sample of tax returns and other data, aged to the year being analyzed. This is the same kind of tax model used by the U.S. Treasury Department, the congressional Joint Committee on Taxation and the Congressional Budget Office. The ITEP model uses the following micro-data sets and aggregate data:

*Micro-Data Sets:*
IRS Individual Public Use Tax File, Level III Sample; IRS Individual Public Use Tax File; Current Population Survey: Consumer Expenditure Survey; U.S. Census, 1990.

*Partial List of Aggregated Data Sources:*
Miscellaneous IRS data; Congressional Budget Office and Joint Committee on Taxation forecasts; other economic data (Commerce Department, WEFA, etc.); state tax department data; data on overall levels of consumption for specific goods (Commerce Department, Census of Services, etc.); state specific consumption and consumption tax data (Census data, Government Finances, etc.); state specific property tax data (Govt. Finances, etc.); American Housing Survey 1990; 1990 Census of Population Housing; etc.

*A more detailed description of the ITEP Microsimulation Tax Model can be found on the ITEP internet site at www.ctj.org\itep\.*