STATEMENT OF THE NEW YORK BANKERS ASSOCIATION

BEFORE THE

NEW YORK STATE SENATE SELECT COMMITTEE ON

BUDGET AND TAX REFORM

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Chairwoman Krueger and Members of the Select Committee, my name is Michael P. Smith and I am President and Chief Executive Officer of the New York State Bankers Association. Thank you for the opportunity to testify today on the equitability of New York State's business and banking tax structures and their effectiveness to foster economic growth Statewide. Our Association is comprised of the commercial banks and thrift institutions doing business in New York State, with assets ranging from trillions of dollars to some of the smallest depository institutions in the country.

Contributions of New York State's Banks and Thrifts to the New York Economy

Our members collectively are among the largest private employers in New York State. Even after the unfortunate loss of a significant number of jobs in the current recession, the State's commercial banks and thrifts employ approximately 250,000 New Yorkers. With offices in virtually every city, town and village, banking is one of the most important contributors to the State's growth.

Beyond employment, banks are among the most important and most reliable sources of funding for housing, small business lending, consumer purchases and other types of funding on which New Yorkers have come to rely. As other lenders have pulled back from the credit extended in the State, banks have continued to lend. We recently completed a survey of small business lending by our members. We received responses from 31 banks and thrifts, from

throughout the State, in size ranging from $100 million to money center institutions, including several in urban areas. These institutions reported that most had increased their small business lending from 2007 to 2008, but that there was a significant fall-off in the first quarter of 2009; that the fall-off was due, in large part, to a combination of a decrease in loan demand, reduction in creditworthiness for small business borrowers, and a tightening of bank loan standards; but that substantial increases in deposits over the same period provide ample liquidity for additional future lending.

These results are consistent with data reported by the federal government. The Federal Deposit Insurance Corporation, summarizing statistics on all New York-based banks and thrifts, shows that total lending increased from 2007 to 2008 by $10 billion. Also, the Treasury Department on Monday released results for March 2009 lending by all depository institutions, showing that loans to consumers held on banks' balance sheets in three categories – first lien mortgages, home equity lines of credit, and other consumer loans – all increased in March. Also, consistent with NYBA's survey, the Treasury reported that banks noted that the demand by businesses for commercial and industrial (C&I) loans was well below normal levels as a result of decreased business appetite for capital expenditure loans and loans to finance acquisitions, plants, equipment, inventories and accounts receivables. Outstanding C&I loan balances fell 2 percent in March. However, in spite of the declines in loans held on banks' balance sheets, originations of new loans accelerated. Originations of virtually all categories of loans increased notably in March. A copy of the Treasury release is attached to this statement.

In addition to employment and lending, New York's banks and thrifts are major contributors to their communities through investments in municipal and State obligations, through charitable contributions and released time for their officers and employees to participate in community leadership, through providing banking services of all types and, most important in the current troubled economic climate, through their support of financial literacy and credit counseling efforts. Virtually every member of the Association provides some form of financial literacy educational effort and many contribute to not-for-

profit counseling agencies that assist New Yorkers in every phase of the credit and money management process.

Taxes Paid by Article 32 Taxpayers

During the third and fourth quarters of 2008, New York's banking industry collectively experienced one of the most severe financial setbacks in its history; yet not a single New York-based bank or thrift failed. Surprisingly, even as other industry groups were reducing the amount of taxes paid to New York State, the revenues the State received from the Bank Tax, according to the State Tax Department, actually increased. In its October 2008 mid-year update, the Department of Taxation and Finance projected that New York State would collect approximately $729 million from banks and thrifts paying taxes under Article 32 of the Tax Law. During 2007-2008, the banking industry paid $880 million under Article 32. In the end-of-year figures released last month, the Department reported that New York's banks and thrifts paid $1.061 billion for the 2008-2009 fiscal year, an increase of more than 20% over 2007-2008 and of more than 31% over the State's budget projections.

By any measure, the State's Article 32 taxpayers are paying their fair share of State tax revenues. Since the enactment of the 1985 Bank Tax Act, banking's share of total corporate taxes, as reported by the Department of Taxation and Finance, increased from 5% to almost 16%, and *double* that for New York City banks. To repeat, in 1985, banks and thrifts paid 5% of the State's corporate taxes. Today, banks and thrifts pay over three times that percentage. In addition, banks employed in 2006 approximately 4% of private, non-farm employees in New York State and produced 5.7% of the State's domestic product. Thus, it is clear that the banking industry's current tax burden is more than appropriate. Consider the other taxes banks and thrifts pay, such as payroll taxes, property taxes, sales and use taxes, New York city corporate income taxes, the MTA surcharge, the New York City Commercial rent tax, and the new Metropolitan Commuter Transportation Mobility Tax – the total of these payments exceeds $5 billion annually.

Incentives in the Bank Tax

The Bank Tax has a number of provisions that distinguish it from other corporate taxes. Like the complexity of our State's economy, our tax laws have been crafted to reflect an industry with several distinct sectors. The industry is comprised of local community banks and thrift institutions, regional multi-state holding companies and the larger national and global banks. The Bank Tax, like many tax provisions, includes incentives and revenue-adjusting formulas to stimulate housing, stabilize local government finance, assist small business, and spur corporate headquarters' building in New York. As the 1985 Act stated, it is also intended "to maintain New York City as a financial center."

The bad debt deduction exists to insulate banks from the volatility of the credit markets and, for thrift institutions, protect their mandate to provide home loans.

The interest and dividend deductions were intended to ensure a consistent flow of revenues to the State, preserve the status of the State as a corporate center and provide a viable market for State and local government securities.

The wage factor discount was incorporated in the law to stimulate New York employment.

These provisions were established in law to ensure stable and predictable revenues for the State, as well as maintain New York as the world's financial capital. These incentives, taken together, have achieved their purpose and continue to help keep New York competitive in the financial services area.

Principles of Bank Tax Reform

The State Department of Taxation and Finance is currently engaged in a major project to determine whether the Bank Tax (Article 32) and the General Corporation Tax (Article 9-A) should be merged. Our Association is working with the Department and urges that the Select Committee consider and adopt some of these principles. We also pledge to work with the Select Committee to develop an appropriate tax strategy for the Bank Tax going forward.

The first and most important principle should be maintenance of New York's position as the world financial capital. As the banking and thrift industries recover from their current weakened condition, they will begin hiring again. It is critical that New York State continue to maintain incentives that make the State – and New York City – attractive places for bank employment. Banks and thrifts operating in New York City already have the highest combined income tax rate in the country – well over 18% even before the new Metropolitan Commuter Transportation Mobility Tax is factored in. Reducing or eliminating the incentives contained in the Bank Tax will make this tax rate even more burdensome. We therefore would strongly oppose any effort to further restrict Bank Tax deductions or credits.

Second, the Bank Tax should contain some of the equitable provisions in the General Corporation Tax. The Bank Tax contains an alternative tax on bank assets, payable in years when the income tax or the alternative minimum tax would produce revenue less than that payable under the tax on assets. Even in years when banks have enormous losses, therefore, the tax on assets continues to require banks to, we think unfairly, pay hundreds of millions of dollars of taxes to New York State. The General Corporation Tax on capital, similar to the tax on assets, is capped at $10 million, so that, even in years when general corporations are losing money, they never have to pay a franchise tax greater than that amount. We strongly urge that the Bank Tax be amended to cap the tax on assets at the same level. The whole principle of an income tax is that taxes should not need to be paid in years when corporations are losing money. The tax on assets defies the basic fairness of that principle, and makes it harder for banks to recover from their loss positions.

Third, New York City, alone among jurisdictions in which our banks pay income taxes, has no net operating loss (NOL) carryforward provision. Federal tax law, the State Bank Tax since 2001, and all of our neighboring jurisdictions honor the principle that corporations that lose money should be allowed to deduct those losses against earnings in later years. Even general corporations operating in New York City have a net operating loss provision. The New York City Bank Tax should be amended to provide a similar NOL for the City's banks and thrifts.

Next, the importance of tax policy to the health of New York's business community is clearly demonstrated by the experience of the New York trust industry. The trust business is leaving New York. Whether measured by assets under management, total personal trusts held, or employment, the trust industry, which remains a hallmark of New York banking, is steadily migrating to other states. Since 2001, New York's share of the nation's personal trust business has declined dramatically. This loss of market share contrasts with the growth of the trust business in other areas of the country. The primary reason for the loss of trust assets, along with the revenue they generate and the employment they call forth, is the State's fiduciary income tax. A personal trust located in New York City pays combined State and City income taxes in excess of 12% of total net income. Simply by moving the trust across the river to New Jersey, a New York taxpayer will avoid, not just the high level of New York income tax, but any state income tax at all. This is because the Tax Law, like that of several other jurisdictions, requires that both a trust grantor and the trustee be New York residents for the trust to be subject to New York tax. If the fiduciary income tax is not reformed, ultimately, the State will lose both the revenue from the tax as well as the revenue from taxes paid by trustees, attorneys, accountants and others who work in the trust business. And, as numerous studies have shown, loss of a single job in the banking industry is accompanied by the loss of at least one other job in ancillary sectors.

Addressing these issues is important for the long-term health of New York. Banks and thrifts that feel they are being discriminated against in Tax Law will undoubtedly find ways to equalize their treatment. As they compete with securities firms, insurance companies, licensed lenders and other financial intermediaries that can take an NOL, are subject to a cap on their alternative tax or have other tax advantages, they may respond by shifting jobs, modifying services and searching for lower cost locations. An unfair or punitive bank tax regime can ultimately only hurt New York, its economy and its citizens.

We appreciate the opportunity that the Select Committee has provided to comment on these important issues.