New York Bankers Association

Statement of Michael P. Smith

President and CEO, New York Bankers Association

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Joint Legislative Budget Hearing

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Good morning. My name is Michael P. Smith. I am President and CEO of the New York Bankers Association. NYBA is comprised of 150 community, regional and money-center commercial banks and thrift institutions operating in New York State, with over 200,000 New York employees.

Thank you for the opportunity to comment on the tax provisions of the Executive Budget. Tax policy is the single most important component in drafting a blueprint for the future of our State's economy. NYBA supports Governor Cuomo's budget goals of modernizing New York's tax code, creating tax policy which encourages business development, and establishing a trust and estate tax environment which encourages New Yorkers to maintain their residency in our state. Recent estimates show that as many as 100,000 New Yorkers migrated out of the State last year; it is clearly imperative that we look at all avenues to encourage businesses to come to and stay in New York, and our citizens to continue to live, work and thrive here.

Corporate Tax Reform and Business Tax Relief

We applaud the recommendations in the Governor's Budget proposal to simplify and modernize the outdated New York tax law, culminating in positive benefits both for the industry and for the general economy.

By way of background, it is important to note that since the last significant modification to the state's Bank Tax in 1985 the financial services industry has undergone major change. The advent of Interstate Banking and Branching under the Riegle-Neal Act of 1994, the modernization elements of the Gramm-Leach-Bliley Act of 1999 and the reforms of the Dodd-Frank Act in 2010 have resulted in a banking system profoundly

different than that which existed in 1985. Thus, the state's tax regime for financial services no longer accurately reflects the industry as it exists today.

The result is an outdated system of taxation that lacks clarity for the taxpayer, is cumbersome to administer for the State's Tax Department and too often ultimately results in lengthy and expensive audits. The Executive's proposal relating to the integration of Articles 9-A and 32 will advance the important goal of creating a simpler and fairer tax code. The resulting benefits include the elimination of current tax disincentives to retaining New York- based employees and New York-based operations.

The proposed merger of the two articles will simplify and modernize tax law in the state through a replacement of the current combined reporting system with a mandatory water's edge unitary combined reporting system and a single sales factor apportionment formula. Such changes will reduce duplicative compliance costs and simplify the burdensome and outdated audit process in the State. A reduction in the franchise tax rate from 7.1% to 6.5% will eliminate disincentives for financial firms to invest and create jobs in New York. We believe these changes will modernize the corporate tax structure for the financial services industry, creating stability and predictability in its fiscal planning. Banking is a fundamental component of New York's history and New York's economy, and this tax reform plan will go a long way toward maintaining our status as a global financial hub. We can think of no better way to make New York attractive to these types of businesses, which bring with them skilled, well-paying jobs.

Another critical component of the corporate tax reform proposal are the provisions allowing qualified community banks and thrifts the opportunity to reduce their income

subject to tax to the extent their activities support residential and small business lending in New York. These provisions ensure that local community lenders, who lend to New York borrowers, will not be competitively disadvantaged. Without these provisions, most community banks would suffer a substantial, and highly inappropriate, tax increase on enactment of the proposal. The resulting impact on the capital strength and independence of these banks and thrifts could have a profound negative impact on the economy of local communities throughout New York. It is essential to the economic vitality of communities to have in their midst financially strong local banks who will ride out economic cycles and remain committed to their local communities.

Further, the "safe harbor" proposal concerning the attribution of interest expense to certain items of exempt income is an important component as well. Given the fact that the stock-in-trade of the financial services industry is borrowing money, we are quite concerned that, without the safe harbor, the cost of losing a deduction for interest expense could wildly exceed any benefit attributable to the exempt income. While the safe harbor does not completely eliminate the disproportionate effect this provision will still have on the financial services community, it at least provides a measure of certainty that will otherwise be lost. We believe that without a safe harbor, a significant source of controversy will remain thereby causing unnecessary uncertainty for both taxpayers and the State and undermining one of the Commission's goals of establishing a reliable tax base upon the initial filing of tax returns vs. post filing audit revenues. We therefore strongly support the safe harbor provision.

Finally, NYBA recommends inclusion of an additional item to the Executive proposal, namely that the Gramm-Leach-Bliley Act (GLBA) transitional tax provisions which were

originally added to the New York Tax Law and New York City's Administrative Code in 2000 to reflect GLBA's removal of the prohibitions against the affiliation of banks, securities firms and insurance companies, be extended in the New York City Administrative Code. The GLBA provisions should remain in effect at the New York City level until the effective date of a new City tax law which integrates the taxation for Article 32 general corporations and banking corporations into one set of laws.

Estate Tax

The Executive Budget proposes a change to the estate tax which would increase the exclusion threshold to the amount of the current federal unified credit over five years and lower the top estate tax rate from its current rate of 16% to 10%. NYBA strongly supports these measures, which would serve as a step in modernizing New York's antiquated trust and estates laws. For example, currently New York is one of only 15 states with an estate tax and only two states currently have a lower exemption.

We believe these changes would not only help reduce the number of citizens and their assets that flee New York for more favorable tax states, such as Florida, but will also result in more revenues for New York in the form of continued income, sales and real estate taxes.

As a technical matter, as drafted, we believe that the goal of this legislation—to gradually increase the New York estate tax exclusion to the "current federal unified credit" – may not be met, as there could be a mismatch between the two exclusions based on a difference in the inflation adjustments: as of April 1, 2017, the New York exclusion would have reached $5.25 million—or an amount that is already out of date,

as that was the basic exclusion amount for 2013. To avoid a potential mismatch, we believe it would make sense to more directly link the New York exclusion to the federal exclusion.

Repeal of the Generation Skipping Transfer Tax

We also strongly support the repeal of the Generation Skipping Transfer (GST) tax. Federal law already imposes such a tax as an effective disincentive to wealth transfers to grandchildren and later generations, and thus New York's tax is unnecessary and overly burdensome. Moreover, this tax, which can also cause taxpayer confusion, affects only a few dozen taxpayers annually and creates minimal revenue for New York. In fact, the November 2013 New York State Tax Reform and Fairness Commission Report states that "fewer than 50 GST [tax] returns are filed and the tax generates less than $500,000 annually." Thus, we believe its elimination will further streamline and simplify New York's tax code, without any significant negative impact on tax revenue.

Tax Treatment of Gifts

The Executive Budget includes a proposal to require that the value of gifts be added back to an estate in many circumstances. We believe this proposal is essentially a re-imposition of a gift tax—the last iteration of which was repealed in 2000— and it is contrary to and inconsistent with the previously discussed estate tax revisions. We therefore strongly oppose its enactment into law. As mentioned above, the primary goal of these changes is to enhance New York's competitive status as a place to live, work and retire in. Yet this proposal would in many circumstances mandate that an adjusted taxable gift made on or after April 1, 2014 be included in the New York estate tax

calculation – that is, a resident New York decedent would include an adjusted taxable gift in his New York gross estate if he was a New York resident when he made the gift, and a non-resident decedent would include an adjustable taxable gift in his New York taxable estate if the gift was of New York-situs real or tangible property or of intangible property used in a New York trade or business. This would be a significant reversal of progressive estate planning policy, create a significant incentive for New Yorkers of means to emigrate from the State, and would put us in the company of only two other states, Connecticut and Minnesota, who continue to maintain a gift tax in this modern era.

The Resident Trust "Loophole"

We also oppose the proposal that would tax an "accumulation distribution" to a New York beneficiary of a nonresident trust or a resident trust that is currently exempt from tax in certain circumstances. New York currently conforms to Federal law, thus actually maintaining a competitive stance in this regard in estate planning that crosses state lines. The proposal as written would have a significant negative impact on New Yorkers and provide additional incentive to leave the State.

It is important to note that this proposal also presents real constitutional challenges, as a significant body of law has already ruled that State tax laws that seek to tax trusts where there is no in-state trustee, assets or source income is unconstitutional.[1]

The proposal would also create additional onerous reporting requirements, to which NYBA strongly objects. As written, it would require a resident trust that claims

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[1] See, for example, *Mercantile-Safe Deposit & Trust Co. v. Murphy,* 15 N.Y.2d 579 (1964), where the New York Court of Appeals found invalid New York's attempt to tax a trust created by a donor domiciled in New York, under these circumstances.

exemption from New York tax because it meets certain requirements to file an informational return "substantiating its entitlement to that exemption and providing such other information as the commissioner may require." Similarly, if there is an "accumulation distribution" to a New York resident, an informational return must be filed. This would require a potentially enormous amount of extra paperwork and recordkeeping—at the commissioner's discretion—much of which may not even exist with respect to existing trusts. Given constitutional considerations, moreover, it is questionable whether New York could compel a nonresident trustee to maintain such records and annually provide the informational filing required under this proposal.

Due to New York trust laws' slow path to modernization and the State's unwelcoming trust tax policies, New York has lost its competitive edge in the trust industry, as most trusts created today for New Yorkers are done out of state. As a result, we have seen a steady outflow of trust industry employees and their income, sales and real estate taxes from our State. We believe this proposed change to the already harmful fiduciary tax would only further encourage the decline of the trust industry in New York, and serve to encourage grantors and beneficiaries to move to other States.

In a 2004 report by Appleseed, a New York City-based economic development consulting firm, commissioned by the Lower Manhattan Development Corporation – which still has great relevance today – it is noted that the difference in fiduciary tax liability between New York and other states, can be extremely substantial. In fact, bankers and attorneys who were interviewed for the report were unanimous in stating that they are obliged to advise their New York clients of the tax advantages to be gained in establishing their trusts out of New York, as trustees have a fiduciary obligation to

protect the financial interests of trust beneficiaries. As a result of this law, and other arcane, inflexible provisions of New York's trust law, businesses, thousands of jobs and tax revenues continue to leave our State annually.

NYBA has long supported the elimination of New York's fiduciary tax as a way to stop the flow of the trust industry, with all of its highly compensated employees, out of New York. Studies have shown that for every trust-related job that exists, one additional job is required to support the function. The trust industry, which is comprised of a complex network of bankers, investment professionals, attorneys and accountants would benefit greatly from the increase in the number of New Yorkers who would choose to live out their lives in New York. Before competing states set out to woo this business, New York dominated this market because of our concentration of highly-skilled practitioners. Closing the resident tax "loophole" can only exacerbate this already alarming outflow of New York citizens, jobs and associated tax.

Conclusion

We wholeheartedly support the concept of providing tax-related incentives for attracting businesses and jobs to our State. We also support the Budget provisions that aim to keep New Yorkers' assets in New York, thereby strengthening our trusts and estates industry.

We look forward to welcoming new financial firms to the State who will seek to take advantage of the stable corporate tax structure that will make for better planning and future growth.

Thank you again for this opportunity to voice our support for many of these tax-related provisions, while suggesting modifications to others.