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Testimony of the Fiscal Policy Institute
Joint Legislative Budget Hearing on Taxes

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Working and middle-class families in New York State have struggled in recent years, facing the strains of the Covid pandemic followed by the pressures of inflation and skyrocketing rents and housing prices. As we confront a potential recession in this upcoming year, it is particularly important to invest in the public services and infrastructure that stabilize the cost of living and the quality of life for ordinary New Yorkers. Chiefly, this will mean sustainably funding care services such as child care and long-term care for the elderly, investing in higher education and childhood education, making up for the last decade of cuts to social welfare spending, enacting pro-tenant housing policies that keep renters in their homes, permanently closing the MTA budget gap, and funding a renewable energy transition. The Executive Budget's proposed investments are inadequate to achieve these social and economic policy goals, constrained by a refusal to raise new revenue.

In this testimony, we provide our view of general economic and social trends in New York State, including the recovery from the Covid pandemic and state trends in poverty, inequality, and population. Then we address a range of tax policy options to (i) raise new revenue and set the state on sound fiscal footing, (ii) reduce poverty through direct cash transfers, and (iii) reform business subsidies that have a poor track record of promoting economic growth.

The Executive Budget Financial Plan

The Executive Budget for Fiscal Year 2024 projects total spending of $227 billion, a 2.4 percent increase over the previous fiscal year. Of this, State Operating Funds total just over $125 billion, a 2.0 percent increase over FY 2023.

The Executive Budget expects fiscal year 2023 revenue to significantly exceed projections made in the fiscal year 2023 enacted budget. The executive budget expects fiscal year 2023 to close with state operating revenue of $128.4 billion. This revenue is $12.4 billion – 10.7 percent – higher than the level projected at the beginning of the fiscal year. Higher fiscal year 2023 revenue is almost entirely attributable to strong personal income tax (PIT) revenue. The fiscal year's $58.4 billion in PIT revenue exceeded initial projections by $11.4 billion – 24.3 percent.

The fiscal year's higher-than-expected PIT revenue reflects a continuation of Covid-era surpluses. Prior to Covid, actual PIT revenue was generally close to enacted budget projections. In recent years, however, conservative

enacted budget projections have consistently underestimated PIT revenue. Fiscal year 2023's 24.3 percent PIT surplus follows the prior year's 17.0 percent surplus.

The executive budget uses the fiscal year 2023 surplus to relieve fiscal pressure in fiscal years 2024 and 2025. Most significantly, the budget uses its surplus to accelerate $5.4 billion of planned deposits into the state's fiscal reserve funds. By prepaying reserve deposits of $2.4 billion and $2.9 billion planned for fiscal years 2024 and 2025, respectively, the budget frees those resources across both years. The budget also shifts a planned $900 million in debt service prepayment from fiscal year 2024 to 2023.

These fiscal year 2023 savings, together with modest revenue action, open fiscal space for fiscal year 2024. The executive budget expects state operating funds revenue in fiscal year 2024 to fall $2.6 billion–2.0 percent–from 2023 levels. While the executive budget expects fiscal year 2024 PIT and sales tax receipts to rise slightly from 2023, this is more than offset by falling revenue from business taxes and miscellaneous receipts. Lower business tax receipts are the result of a projected decline in partnership income and corporate profits driving down pass-through entity tax (PTET) and corporate franchise tax (CFT) revenue, respectively.

Revenue in the outyears–fiscal years 2025 through 2027–was revised down significantly between fiscal year 2023 and 2024 projections. The budget revises down both PIT and business taxes for each outyear. These revisions result in an average of $6.2 billion lower total state operating funds revenue for each of the three outyears. The increase in outyear budget gaps between fiscal year 2023 and 2024 projections is entirely the result of lower PIT and business tax revenue projections, not revisions to spending.

Part I: Economic and Demographic Trends

The Economic Outlook for FY 2024

New York's fiscal year 2024 executive budget makes conservative projections within the range of other forecasters. The budget expects 0.5 percent GDP growth and 4.3 percent unemployment in 2023. The budget's GDP estimate falls at the bottom of the range of estimates made during the state's quick start process, in which the state's executive office, legislature, and comptroller contribute economic and fiscal forecasts. The state's Division of Budget generally uses conservative economic projections to minimize downside fiscal risks. The most recent economic data, however, shows continued unwinding of price and wage inflation and amid continued labor market resilience. These indicators appear to be consistent with a "soft landing" in which inflation returns to its two percent target without heightened interest rates triggering a recession.[1]

Importantly, DOB's economic outlook revised its economic expectations for both the U.S. and New York State downward not just for 2023, but for following years as well. In its fiscal year 2023 economic outlook, DOB expected real GDP growth of 2.3 percent and 2.4 percent in 2024 and 2025, respectively. This year, DOB marked these projections down to 1.7 percent and 2.3 percent, respectively. Expected personal income growth was

[1] https://www.ft.com/content/cb2d25a3-456e-4cd7-bb27-484fe9776340

similarly revised down.[2] While apparently minor, changes to these forecasts can affect significant revisions to future revenue projections.

It is almost certain that in 2023 economic growth will slow and unemployment will rise. Whether the slowing economy will avoid a recession remains unclear. For state policymakers, the formal declaration of a recession in the U.S. matters less than the timing and severity of fiscal and economic downturns. Policymakers face the daunting balancing act of conservatively budgeting revenue projections to ensure spending can be covered in a downturn while ensuring investments are sufficient to provide services for the New Yorkers who will bear the brunt of a downturn.

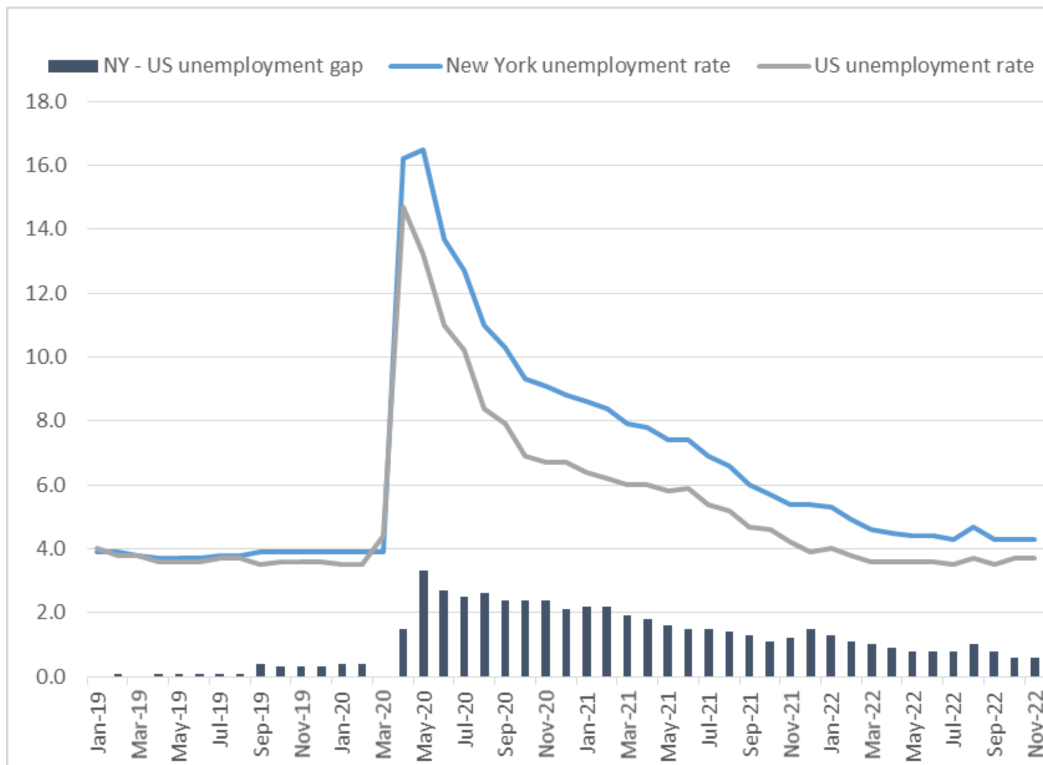
New York's Recovery from the Covid Pandemic

The recession caused by the Covid pandemic was far more intense than past recessions, but also shorter lived. The U.S.'s first major epicenter, New York suffered devastating loss of life in the first months of the pandemic. Between February 2020 and April 2020, the state lost nearly two million jobs, a 20.2 percent drop. For the U.S. overall, 14.4 percent of jobs were lost in the Covid recession. The number of active claims for unemployment insurance in the state rose from 167 thousand immediately before the March lockdowns to 2.2 million in May 2020. New York's unemployment rate reached a peak of 16.5 percent in May 2020, nearly two percentage points higher than the U.S. rate. By the end of 2020, unemployment was more than halfway back to pre-pandemic levels. The state economy continues to add jobs, but the pace of employment recovery has been uneven across the state and sectors of its economy.

New York's unemployment was on par with the U.S. unemployment rate through 2019. After rising from 3.9 to 16.5 percent between March and May 2020, New York's unemployment rate began falling quickly. The state's unemployment rate was 8.8 percent by the end of 2020, and fell to 4.3 percent in July 2022, a level at which it has since generally remained. Since July 2022, the U.S. unemployment rate has oscillated around 3.6 percent — 0.7 percentage points below the New York rate. This differential is driven by New York City's persistently elevated unemployment rate, which stood at 5.9 percent in December 2022. Excluding the city, the state's unemployment would be 3.2 percent.

Unemployment in the US and New York, 2019-2022

[2] https://www.budget.ny.gov/pubs/archive/fy23/ex/ero/fy23ero.pdf; https://www.budget.ny.gov/pubs/archive/fy24/ex/ero/fy24ero.pdf

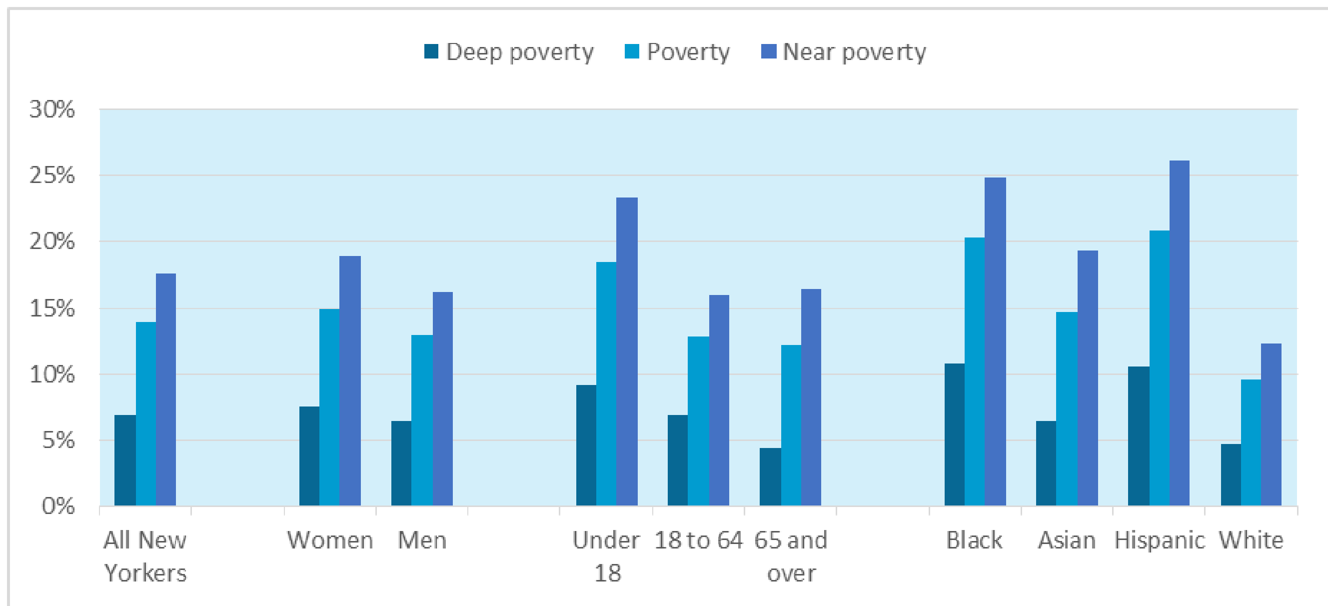


Poverty & Inequality

After falling to a historically low 12.7 percent in 2020 – driven by unprecedented federal relief funding – poverty in New York ticked up in 2021, the most recent year for which data is available. With stimulus programs winding down in 2021, the state's poverty rate rose to 13.9 percent, 0.8 percentage points higher than 2019. By comparison, the U.S. poverty rate rose from 11.9 percent in 2020 to 12.8 percent in 2021.

Poverty varies considerably across demographic groups. In 2021, 6.9 percent of New Yorkers lived in deep poverty in 2021, with incomes less than half of the federal poverty level (itself an inadequate gauge of economic hardship). This rate was higher for Black and Hispanic New Yorkers as well as those under age 18, who experienced deep poverty at rates of 10.8 percent, 10.6 percent, and 9.2 percent, respectively. These trends held across poverty levels, with economic hardship disproportionately affecting women, children, and Black, Hispanic, and Asian New Yorkers. Nearly one-quarter of children (23.4 percent) and Black New Yorkers (24.9) and more than one-quarter of Hispanic New Yorkers (26.2 percent) experienced near poverty in 2021, with incomes less than 125 percent of the federal poverty level.

Poverty level by selected characteristics, 2021



Inequality

Income statistics have long shown that the top earners in New York State earn relatively more than their counterparts elsewhere in the U.S. Income inequality alone, however, provides an incomplete picture of the wealthiest households' economic resources. In order to understand real economic power, we have to look at households' wealth (their total net assets). Wealth accumulates over generations, often escapes taxation, and enables the ultra-rich to make major expenditures and leverage capital. Wealth is also distributed very unevenly across racial groups. Nationally, white households hold 86 percent of all wealth and 92 percent of extreme wealth.

While measuring wealth inequality is difficult, research recently published by the Institute on Taxation and Economic Policy (ITEP) sheds new light on the geographic concentration of extreme wealth (defined as households with a net worth of $30 million or more). ITEP finds that, like income inequality, New York is home to the greatest concentration of extreme wealth in the country: the wealthiest New Yorkers together own $6.7 trillion in net assets, much of which will never be taxed under current law.

New York State has the highest level of income inequality in the U.S. In a 2018 study, the Economic Policy Institute found that the average income of the top 1 percent of earners in New York was over 44 times the average income of the bottom 99 percent — the most extreme disparity of any state. This ratio is driven by the stratospheric top incomes, which were concentrated in Manhattan. The borough's top 1 percent earned an average of $8.98 million per year.i More recent Census data confirms this conclusion, estimating New York's Gini coefficient — which gauges disparity across the income distribution — to be 0.514, the highest of any state.

The data reveal a striking concurrence of the geographic concentrations of top incomes and extreme wealth. New York, which hosts the nation's highest level of income inequality, is also home to its greatest concentration of extreme wealth. ITEP estimates that households in the U.S. that are worth over $30 million (whom we will

call the “ultra-rich”) collectively hold $38.9 trillion in wealth. Of this, the ultra-rich in New York State collectively hold $6.7 trillion in wealth, or about one-fifth of all wealth owned by the ultra-rich in the U.S. This makes New York State home to the most extreme wealth on both an absolute basis and in relation to its total population.

The subset of 78 billionaire households in New York hold $673 billion in wealth. This places New York second in the nation in billionaire wealth, after California (where billionaires hold $945 billion). California’s population of 39 million, however, is about twice that of New York’s (20 million). This concentration of wealth is largely due to New York’s financial industry.

ITEP further estimates the unrealized capital gains held by both the ultra-rich as well as the subset of billionaires. Of the $6.7 trillion held by New York’s ultra-rich, $3.1 trillion is in unrealized capital gains (appreciated stock, real estate, or other assets that have not been sold). New York’s billionaires hold $470 billion of their $673 billion in unrealized capital gains. A significant part of these unrealized gains will not be taxed under current law, due to the step up in basis rules, which eliminate taxable gain when assets are passed on to one’s heirs at death, and because the ultra-rich often contribute their holdings to private foundations.

Population Trends

New York State’s total population was hit hard by Covid. After more than a decade of continued population growth, the state population has fallen every year since 2020. Population losses have been led by net domestic outflow — New Yorkers leaving for other states in excess of residents of other U.S. states moving into New York. However, net domestic outflow is not new to New York. A major port of entry to the U.S., New York has long attracted international immigration, as well as younger Americans, while sending residents, on net, to the rest of the country. This model has historically been consistent with sustained population growth and economic dynamism. For this reason, a deeper analysis of the state’s population dynamics and their relationship with its fiscal and economic structures is necessary to provide full context for current trends.

The most recent U.S. Census Bureau population estimates find that the state’s population fell by 180,000 to 19.7 million between 2021 and 2022. This loss was lower than the decline of 251,000 in 2021, but remains above 2020’s decline of 93,000 and sets NY’s population back after a decade of sustained population growth prior to the Covid pandemic.

Cities are home to the nation’s highest-productivity and highest-value economic sectors. At the same time, urban centers in the U.S. tend to experience sustained net domestic outflows. This is true of cities in the Northeast and California as well as sunbelt states like Florida and Texas. While this trend has accelerated in recent years, a continuous flow of Americans from cities to the suburbs predated the Covid pandemic. Nevertheless, the populations of large U.S. cities, including New York City, have generally continued to grow, their populations driven by births outnumbering deaths and by immigration from abroad. This dynamic is possible even in a demographically static city. If two adults move into a city, start a family, and decamp for the suburbs as a family of four, outflow (4 people moved out) will have doubled inflow (2 people moved in) despite no lasting change to the city’s demographic composition.

New York is particularly exposed to this dynamic due to the urban concentration of its population: Nearly two-thirds (65 percent) of the state's population lives in the New York metropolitan area. Because the state's labor markets outside the New York metropolitan area are generally weaker, downstate population growth necessarily sets the pace of the state's growth. However, 62 percent of the metropolitan area's suburbs — the expected relative recipients of net in-migration from the city — are not in New York State.

The cost of housing likely drives these migration patterns. Housing costs are the largest single expenditure for the average U.S. household. New York City and its in-state suburbs tend to have far higher housing costs than out-of-state suburban counties, or other top destinations for outbound New Yorkers. **Of the top twenty largest county-to-county flows out of New York State, median housing costs were substantially lower in the destination county.** (Note that migration data is available on a county-to-county basis). On average, annual mortgage costs for median-priced homes are $18,300 lower in destination counties — a savings of 34 percent — than in New York origin counties. In six of the twenty county-to-county pairs, median home prices in the New York origin county were twice as high as in the destination county. New York housing costs were higher than destination costs for all groups except Bronx residents heading to Fairfield County, Connecticut or Bergen County, New Jersey. Three other major New York suburban counties — Rockland, Nassau, and Suffolk — have higher median home prices than all neighboring out-of-state suburbs (even though these counties are not in the top twenty county-to-county migration pairs).

As most New York City households are renters, New York's high rents also play a significant role driving households towards the suburbs. Of the top twenty county-to-county moves out of New York, renters are likely to reap savings in all but two. On average, rents are $5,600, or 19 percent, lower in destination counties than in their respective New York origin counties.

Differences in housing costs for New York's out-migrants far exceed prospective savings on state and local taxes. Across all twenty county-to-county pairs, median income families leaving New York can expect average annual tax savings of $1,200 — 15 times less than they might save on mortgage costs and five times less than potential rent savings. In other words**, the typical family that moves out of New York State saves 15 times more from lower housing costs than they do from lower taxes.** Mortgage cost savings were at least eight times higher than tax savings in 16 of the 20 county-to-county pairs. For households moving for economic reasons, cost differentials for their largest single expenditure — housing — vastly exceed any potential tax savings.

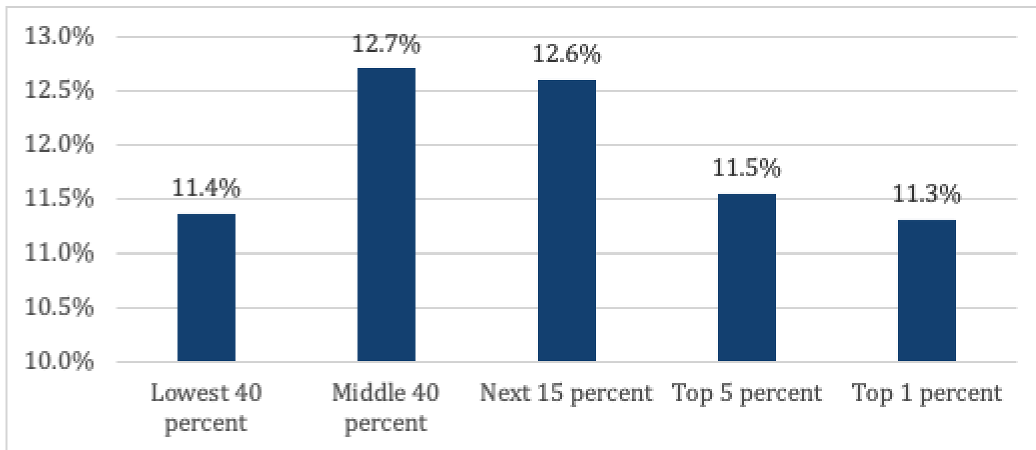
Part II: Policy Recommendations

New York's Tax Structure

Taken as a whole, New York's tax system is regressive: the wealthy pay a lower combined state and local tax rate than those in middle income brackets, and about the same combined state and local tax rate as the poor. The state's personal income tax (PIT) is the only progressive component of the state's tax system, imposing higher rates on higher income earners. Sales taxes, which are levied at the state and local level, and property taxes, assessed only at the local level, are regressive, taking a larger share of income from the lowest income households. A 2019 ITEP report finds that taken together, these three taxes — income tax, sales tax, and property tax — are effectively flat

across the income distribution. The bottom 40 percent of households and the top 1 percent of households pay nearly the same state and local tax rates of just over 11 percent, while the middle 55 percent pay a rate of 12.5 to 13 percent.[3]

Tax Burden in New York State by Income Group



Source: ITEP

New York State's tax system is highly reliant on the PIT. In fiscal year 2022, PIT receipts accounted for 58.4 percent of all state tax revenue. In turn, PIT revenue is highly dependent on the highest income New York tax filers. This is a result of New York's extreme income inequality as well as its progressive PIT rates. In tax year 2020, the most recent available, 128,700 tax filers reported New York gross adjusted income above $1 million, 1.2 percent of all tax filers. These filers collectively paid 41.9 percent of all PIT liability.[4] The state's PIT rates are modestly progressive across the income distribution as a result of recent policy changes. However, income as the sole basis for progressive taxation overlooks the far more unequally-distributed resources available to the wealthiest New Yorkers.

These findings reveal enormous reserves of wealth in New York held not just by a few billionaires, but a class of top wealth holders whose numbers rival the state's top earners. While the two groups may not neatly overlap, recent evidence suggests that top wage earnings and wealth holdings increasingly belong to the same households in the U.S.[5] Taken together, these households represent a core element of the state's tax base. A tax system that accounts for the extreme wealth concentrated at the top of the distribution would raise more revenue from top wealth holders than a PIT that appears progressive only against the benchmark of the relatively more egalitarian income distribution.

Moving toward such a tax system does not imply a single set of tax policies. Rather the options that the state might pursue depend on the policies' legal status, administrative complexity, and fiscal and economic conditions. In some cases, complementary policies, or policies designed to expand over time, may be appropriate. This testimony provides an overview of tax policy options that would increase revenue, increase progressivity, and reduce inequality in New York State. It covers seven options over three major areas of taxation: income taxes, business taxes, and wealth taxes.

[3] Meg Wiehle et al. "Who Pays? A Distributional Analysis of the Tax Systems in all 50 States: Sixth Edition" *Institute on Taxation and Economic Policy* (October 2018), itep.org/whopays/.
[4] New York State Department of Taxation and Finance, "Personal Income Tax Filers, Summary Dataset 3 - Statewide Major Items and Income & Deduction Components by Liability Status and Detail Income Range: Beginning Tax Year 2015" (accessed October 2022), data.ny.gov/Government-Finance/Personal-Income-Tax-Filers-Summary-Dataset-3-State/rt8x-r6c8.
[5] Yonatan Berman and Branko Milanovic, Homoploutia: Top Labor and Capital Incomes in the United States, 1950-2020, World Inequality Lab (December 2020), wid.world/document/homoploutia-top-labor-and-capital-incomes-in-the-united-states-1950-2020-world-inequality-lab-wp-2020-27/.

Tax Policy Options

1. Increase the Progressivity of the Personal Income Tax

Prior to the 2008 financial crisis, New York's PIT was flat for all income earned above $40,000.[6] To fill budget gaps created by the ensuing recession, lawmakers created two higher tax brackets on income above $300,000 and $500,000. As the state's fiscal condition improved, PIT rates were lowered for upper-middle class tax filers earning less than $1 million. The fiscal crisis that followed the Covid pandemic created a new impetus for progressive taxation. Lawmakers raised taxes on incomes over $1 million per year and created two new brackets for those earning $5 million and $25 million per year.

Because income and wealth are closely correlated, a progressive PIT is an effective and easily implemented tool to raise revenue from holders of extreme wealth. Lawmakers can quickly adjust PIT rates in response to fiscal conditions and target top incomes at a granular level. The recently enacted top PIT rate increases represent the first time the state's rates began to account for the lopsided concentration of resources held at the top of the income and wealth distributions.

At a minimum, data on extreme wealth suggest that the state should not allow the new PIT rates to expire, as they are currently set to, in 2027. Further, the state should increase the rates for the "millionaire" brackets (for about $1 million, $5 million, and $25 million in annual income), and restore the $500,000 tax bracket from the post-financial crisis years.

2. Raise the Tax Rate on Long-Term Capital Gains

The U.S. federal tax code distinguishes between two types of income: ordinary income, which we can generally think of as wage and salary income, and capital gain, which we can generally understand as income from investments (e.g., the sale of appreciated stock). Where a taxpayer has capital gain that results from the sale of an asset that has been held for longer than one year, the gain is "long-term capital gain" and subject to lower, preferential tax rates. While the top U.S. federal income tax rate is 37% for a married couple filing jointly with earnings over $648,000, the top long-term capital gains rate is 20% for a married couple earning over $517,000.

Since 2020, a group of New York legislators have proposed increasing the state tax rate on long-term capital gains. While New York's Personal Income Tax imposes the same tax rates on ordinary income and capital gain, these legislative proposals have explicitly identified the large federal tax benefit for investment income as the motivation for a long-term capital gains surtax. A state surtax on long-term capital gains could raise substantial revenue, and would offset some or all of the federal tax rate benefit.

We evaluate three options for increasing the New York State tax rate on long-term capital gains. The options assessed here include: (1) a low surtax rate of 1% and 2%, (2) moderate surtaxes of 2% and 4%, and (3) surtaxes of 7.5% and 15%, as proposed in bill S2162/A2576 sponsored by Senator Gustavo Rivera and Assembly Member Ron Kim.

[6] All rates are for joint return filers. New York State Department of Taxation and Finance, "2020 personal income tax forms: IT-201-I" and past editions (accessed October 2022), tax.ny.gov/forms/prvforms/income_tax_2020.htm.

Proposal	Income Level			Total Revenue
	< $500,000	$500,000-$1,000,000	> $1,000,000	
Low Surtax	0%	1%	2%	$1,663,000,000
Moderate Surtax	0%	2%	4%	$3,326,000,000
Rivera/Kim Bill	0%	7.50%	15%	$12,472,000,000
Source: Revenue estimates by FPI and the Institute on Taxation and Economic Policy (ITEP)				

Only 1.3% of tax filers in New York would be affected by these proposals, and only 0.83% of tax filers would be subject to the highest surtax rate under these proposals (the $1M bracket). This incidence breakdown applies to all three proposals since they have the same income brackets guiding the rate increases. Under any of these three proposals, about 99% of tax filers in New York would see zero change in their tax rates.

3. Tax Capital Gains on a Mark-to-Market Basis

Importantly, our current tax system only taxes capital gains when the underlying asset is actually sold (for instance, when an individual sells appreciated stock). In tax parlance, this is called “realizing” the gain. This system leaves vast sums of unrealized capital gains on the table. ITEP estimates that New Yorkers with more than $30 million in assets collectively hold more than $3 trillion in unrealized capital gains — 46 percent of their total wealth. Much of this wealth will not be taxed under current law, largely due to the step up in basis rules that eliminate taxable gain when assets are passed on to one’s heirs at death. Moreover, wealthy families often borrow against accumulated assets in order to finance their lifestyles, while avoiding the tax consequences of a sale. Finally, wealthy individuals often contribute their appreciated assets to private foundations run by their own family members, avoiding tax on their gains while keeping their assets in the family for all practical purposes.

A “mark-to-market” income tax system would tax asset appreciation as it occurs, rather than waiting for the taxpayer to realize their gains. For instance, if a wealthy individual’s investment portfolio grows in value by $10 million over the course of a year, they would be treated as earning $10 million of taxable income in that year.[ii]

Implementing a comprehensive mark-to-market income tax on ultra-rich taxpayers would require annual valuations of all assets in order to measure the annual gains. Critics commonly hold that this is practically impossible or else unreasonably burdensome, but tax law scholars have shown how the challenge could be met.[iii] Additionally, mark-to-market rules could be applied to all of a taxpayer’s historical unrealized gains, or imposed only on a prospective basis. The former option would immediately raise windfall revenue before falling to a baseline annual revenue. A more incremental option would be to only tax current year capital gains on a mark-to-market basis, thereby foregoing the initial windfall revenue. The scope of the tax could be further limited to publicly traded instruments, so as to avoid the challenges of valuing private assets.

4. Tax the Profits of Pass-Through Businesses

The wealth of the ultra-rich generally takes the form of business holdings, whether through privately or publicly owned corporations, or through “pass-through” businesses such as partnerships and LLCs. Taxing business profits is thus an important policy tool for both reducing inequality and raising revenue. While many people think of all businesses as “corporations,” the corporation is in fact only one type of business entity. Most businesses are now

formed as LLCs or partnerships, which are called "pass-through entities" because they are not subject to the corporate tax — rather, the profits are only taxed at the level of the individual owners.[iv]

A starting point for taxing pass-through entities is New York's Pass-Through Entity Tax (PTET). Currently, this tax is 100 percent rebated, bringing in no additional revenue. The tax is not designed to raise revenue, but rather to work around the federal limitation of the state and local tax deduction, and it overwhelmingly benefits the wealthy. According to ITEP, 85 percent of the benefit of the state and local tax deduction in New York State goes to the top 5 percent of income earners. Because these taxpayers will still benefit from electing to pay the PTET even without a full rebate, New York should only rebate part of the tax. For instance, Connecticut rebates only 87.5 percent of its Pass-Through Entity Tax.

5. Tax the Profit-Shifting of Multinational Corporations

Another appealing option for increasing revenue from business taxes is increasing New York's conformity with a provision of the 2017 Tax Cuts and Jobs Act known as "GILTI" or global intangible low-taxed income. This provision targets the profit-shifting of multinational corporations by taxing unusually high profits in overseas jurisdictions. It is generally thought that such high profits result from shifting valuable intellectual property into foreign low-tax jurisdictions. New York currently exempts 95% of GILTI income from its corporate tax base, and apportions no GILTI income to New York. This approach leaves significant potential revenue on the table.

6. Reform the Estate Tax, or Tax Inherited Income

In principle, the estate tax should function as a tax on accumulated wealth at the end of an individual's life. However, it has largely ceased to perform this role due to a few unfortunate features of current estate tax law. Chief among them are that (i) the step up in basis rules eliminate taxable gain upon death, (ii) the estate tax exemption has continued to rise (currently, the first $26 million of an estate is exempt from federal estate tax), (iii) the wealthy can contribute their assets to a private foundation, thereby avoiding estate tax, and (iv) the estate tax planning industry has developed sophisticated tax avoidance techniques.

New York could reform any of the above features of its estate tax in order to more effectively tax accumulated wealth at death. Or, it could shift to a new, simpler inheritance tax scheme whereby inherited income is included in the recipient's income, putting it on par with wage income and investment income.[v]

7. Enable a Direct Wealth Tax

Finally, New York could seek to impose an annual tax on the total wealth of the ultra-rich. ITEP estimates potential revenue from wealth taxes on holdings above $30 million and $1 billion at annual rates of 2, 3, and 4 percent. For New York, a 3 percent tax on wealth held above $30 million would raise $134.4 billion, greater than the entire New York State operating budget in fiscal year 2023. The same rate on wealth held above $1 billion would raise $13.2 billion.

Because a wealth tax would likely incentivize top holders to adopt tax avoidance strategies, a lower rate applied to a broader base would perform better than a higher rate on a narrower base. For New York, nearly $6 trillion of wealth is held by ultra-rich households that are not billionaires. Given that this group contains nearly 30 thousand households—rather than 78 billionaires—it makes for a sounder base for a potential wealth tax.

A state level wealth tax does face one considerable obstacles to implementation. The New York State Constitution prohibits a direct wealth tax, so a constitutional amendment would be necessary.

8. **Reform the Earned Income Tax Credit and Empire State Child Credit**

In addition to raising revenue, the tax law is a major tool for poverty relief policy. The state should act to eliminate the carve-out from the Empire State Child Credit for children under 4, include ITIN filers in the scope of the credit, and eliminate the phase out that leaves out very low income earners. The proposed "Working Families Tax Credit" in particular would make many of the necessary reforms to expand state poverty relief to the poorest New Yorkers, while simplifying the administration of the credit.

9. **End Ineffective Economic Development Tax Credits**

Contrary to the Executive Budget's proposed expansion of the Film Tax Credit by $280 million, the state should look to reduce expenditures on business incentives, which are widely considered ineffective policy measures that strip away the tax base without promoting real economic growth.

[i] Estelle Sommeiller and Mark Price, "The new gilded age: Income inequality in the U.S. by state, metropolitan area, and country," *Economic Policy Institute* (July 2018), epi.org/publication/the-new-gilded-age-income-inequality-in-the-u-s-by-state-metropolitan-area-and-county/.

[ii] For years in which the individual's portfolio loses value overall, such losses could be carried into prior or future years to offset gains, thus achieving fair tax treatment of their real economic income over time.

[iii] Brian Galle, David Gamage, Darien Shanske, "Solving the Valuation Challenge: The ULTRA Method for Taxing Extreme Wealth", *Duke Law Journal* (forthcoming), available at papers.ssrn.com/sol3/papers.cfm?abstract_id=4036716.

[iv] As of 2014, 95 percent of businesses were organized as pass-through entities. Aaron Krupkin and Adam Looney, "9 facts about pass-through businesses" *Brookings Institute* (May 15, 2017) brookings.edu/research/9-facts-about-pass-through-businesses.

[v] For an extended analysis of the benefits and mechanics of an inheritance tax, see Lily L. Batchelder, "Leveling the Playing Field between Inherited Income and Income from Work through an Inheritance Tax", *NYU Law and Economics Research Paper Series* (February 2020), available at papers.ssrn.com/sol3/papers.cfm?abstract_id=3526520.