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Hon. Liz Krueger, Chair, Senate Standing Committee on Finance

Hon. J. Gary Pretlow, Chair, Assembly Standing Committee on Ways and Means

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Members of the Senate Finance and Assembly Ways and Means Committees. I am George V. Sweeting, a senior fellow at the Center for New York City Affairs at The New School. Thank you for the opportunity to submit written testimony for the tax revenue hearing on the New York State 2025-2026 Executive Budget.

Through the first three-quarters of the 2025-2026 State Fiscal Year, actual General Fund tax receipts were \$2.2 billion higher than the amount anticipated when the budget was enacted last spring. Most of the difference is in the outlook for personal income tax receipts, currently \$1.7 billion above the enacted amount. The strength in tax revenues, combined with lower than anticipated disbursements, has created room in the Governor's budget for a number of tax policy proposals.

My testimony will focus on four of these proposals. Three of them would reduce tax revenues. They are a one-time inflation refund credit (IRC), enhancement of the state's child credit, and modest rate reductions in five lowest PIT brackets. The fourth would raise taxes relative to the current law baseline by extending temporary higher income tax rates and brackets for the PIT that were scheduled to expire beginning with the 2026 tax year.

I assess each of these proposals below. In summary my recommendations are as follows:

- **Inflation Refund Credit:** The IRC purports to "refund" a sales tax windfall that the State received, due to surging inflation, by providing a personal income tax (PIT) tax credit to filers against their 2025 taxes. The credit is, however, poorly designed and very inefficient, giving an equal benefit to those with incomes of \$300,000 and those with very low incomes. The latter felt the impact of inflation much more than the former. The credit should be restructured to provide a deeper benefit to low-income households. Restructuring would likely free up some of the \$3 billion now slated for the IRC to address other needs.
- **NYS Child Tax Credit Enhancement:** The Governor's Budget expands the state's child credit from \$330 per child to \$1,000 for each child under the age of four. For those ages 4 to 16, the credit would grow to \$500 per child over two years. Child tax credits have proven to be effective policies in reducing child poverty and these changes would bring New York State into the mainstream. Notably, the current version of the legislation only provides for the enhanced credit for three years. The enhanced credit is a significant benefit to families in need that advocates have been fighting for. It makes no sense to offer the larger benefit for three years and then allow it to revert to the previous version of the credit.
- **PIT Rate Reductions for middle- and low-income filers:** The budget would modestly lower the tax rate in each of the first five brackets in the state's PIT rate table. Most of the benefit will flow to middle- and lower-income taxpayers, but the design of the proposal would also benefit higher-income households earning up to \$161,550. Providing a bigger bang for the bucks would require

adjusting the brackets or, even better, following the lead of New York City's proposed "Axe the Tax" credit, which more efficiently targets low-income filers.

- **Extending temporary higher-income tax rates:** The governor has proposed extending the high-earner tax brackets put in place during the Covid recession through 2032. These brackets are currently set to expire at the end of tax year 2025. The State Division of the Budget has estimated that allowing them to expire would reduce State revenues by about \$5 billion annually. Given that there is little evidence that the higher rates have led to a large increase in the number of high-income earners leaving the state, New York can safely extend them. This would allow the state to address some of its structural imbalance between revenues and expenditures.

Now, to address each of these four proposals in greater detail:

Inflation Refund Credit (IRC). The Governor's Executive Budget proposes to use roughly \$3 billion of the current year surplus to fund a one-time tax credit to "refund" some of the sales tax revenue growth that the Governor attributes to inflation. Generally, sales tax rates are not adjusted on a year-to-year basis, so when the prices of goods and services increase, sales tax revenues tend to increase proportionately.

This credit would pay current taxpayers who were full-time residents of the state in 2023 and who filed a tax return for that year. The credit amount varies by tax filing status and income. Married couples filing jointly with income up to \$300,000 are eligible. Single filers, heads-of-households, and married couples filing separately are eligible if their income is below \$150,000. The credit would be worth \$500 for joint filers and \$300 for others. For those eligible, the credit would be applied to 2025 tax filings. Because the credit is refundable, taxpayers would get the full value of the credit even if their tax liability before applying the credit was less than the value of the credit, with the balance being paid as a refund.

The effects of inflation vary across households. In general, lower-income households spend a greater share of their income on goods and services subject to sales tax than do upper-income households. In New York City in recent years, an overall rise in real wages has outpaced inflation. However, this masks strong differences by household income level. A recent report by the Center for New York City Affairs found that average real wages for the top quintile of workers in the city grew annually by 4.3 percent from 2019 to 2023. Meanwhile, the lowest three quintiles of wage earners experienced much slower real wage growth annually during this time period, averaging 1.5 percent, 1.0 percent, and 1.3 percent, respectively, exacerbating the already existing income gap in the city.

The credit as designed would benefit roughly 8.6 million taxpayers, which is 93.0 percent of all full-year resident taxpayers (in this testimony, I refer to "taxpayers" to

refer to a tax return filing, which can cover one or more individuals). Given the large amount of money involved and the broad eligible population, it is important to review whether the money is being spent in a way that most efficiently targets the benefits to those who need the most help and avoids spending too much on households for whom the benefit would make little difference in their welfare. The short answer: the IRC could be altered to provide a deeper benefit to households that would receive a much greater benefit in percentage terms than higher-income households.

The IRC as proposed does a good job of distributing benefits proportionate to taxpayer liability, but the IRC's relatively small contribution to upper-income household budgets creates an opportunity to redistribute more of the IRC benefits to lower-income households. Such an adjustment would also help blunt the effects of the unequal real wage growth in the city.

For example, if the cutoffs for the IRC were lowered to \$40,000 for single-filers and heads of households and \$80,000 for married joint filers (the latter is close to the median household income in New York) the number eligible would fall from 8.6 million to 6.6 million. The dollar value of the credit would be set depending on how much of the original \$3 billion the Governor and State Legislature wish to continue using for the IRC. Leaving them as is would reduce the cost to \$2.6 billion. Any budget savings could be applied to other needs.

Although the Exec Budget treats the IRC as a one-time non-recurring program there are other options for what to do with this year's revenue surplus, without creating programs requiring recurring funding. For example, some, or all, of the money could be saved to provide short-term funding to deal with potential damage Trump administration policies could pose for the state. Another option could be to make one-time supplemental contributions to the capital budgets of the MTA and other transportation systems across the state to fund projects on a Pay-As-You-Go (PAYGO) basis. Another option would be to help fund the construction of additional classrooms needed to meet the class size reduction targets the state has imposed on the city.

Enhance the New York State Child Tax Credit. The Governor's budget proposes to expand the existing Empire State Child Tax Credit over two years by enlarging the available value of the credit and by removing a provision that is currently preventing households with the lowest incomes from receiving the full benefit of the credit. The credit is claimed when households file their New York State personal income tax returns. As presently drafted, these enhancements would only be in place through 2027.

The current credit amount is \$330 per qualifying child. Under the proposal, in tax year 2025 the credit would be raised to \$1,000 for each child below the age of four in the household. For those aged four to 16 the credit amount would remain \$330 before rising to \$500 in tax year 2026. The value of the credit is gradually reduced for families

with gross income (as reported to the IRS) above \$110,000 and \$75,000 for those who file their taxes as heads-of-household. The \$1,000 and \$500 amounts and phase-out thresholds would remain in effect for tax year 2027.

Reducing child poverty has been shown to benefit the families involved not only immediately but also into the future. The power of child tax credits to help reduce child poverty was demonstrated during the Covid pandemic. The federal government's relief programs included expansion of the federal child credit. The Columbia University Center on Poverty and Social Policy found the changes enacted in 2021 helped reduce child poverty by over 40 percent in New York. Many of those emergency initiatives implemented during the Covid years have been partially or fully reversed or have expired. Estimates indicate that enactment of the Governor's proposal would reduce child poverty by about 10 percent in the state, making enactment of the enhanced credit imperative. This would help to move the State towards the goal of a 50 percent reduction in child poverty by 2031 that was laid out in the state's Child Poverty Protection Act, enacted in 2021.

Lower Tax Rates in the Five Lowest PIT Tax Brackets. The budget would reduce rates in the first five brackets in the PIT tax tables by 20 basis points in a two-step process spanning tax years 2025 and 2026. For example, a married couple filing jointly with taxable income of \$25,000 (which falls into the fourth bracket of \$23,601 to \$27,900) currently pay at the rate of 5.25 percent. Under the proposal their new rate for tax year 2026 would be 5.05 percent, saving them \$49.80 or five percent. We estimate that this change will lower tax revenues by about \$450 million in SFY 2025-2026 and about \$1.0 billion in 2026-2027.

This proposal has been described as a middle-class tax cut, but the benefit also flows to others not usually considered middle class. Notably, the highest bracket where the rate is reduced is extremely wide, spanning from \$27,900 to \$161,550 for joint filers. At the top of this bracket, the savings would be \$331. By contrast, the middle 20 percent of the New York income distribution ranges from about \$52,000 to \$92,000. Also, given the progressive structure of the state's PIT, the lower rates in the lower brackets benefit taxpayers including those whose taxable income falls into the sixth and seventh brackets. (New York begins to "recapture" the benefit of the progressive rates for those with income above the bottom of the fifth bracket.) Options for better targeting middle- and lower-income filers include adding additional tax brackets or considering a well-targeted tax credit such as the proposed New York City "Axe the Tax" credit, which fully or partially reduces personal income tax liability in the first few brackets. The legislative language to establish the city credit is included in the Governor's Revenue Budget bill.

Extend the Personal Income Tax High Earner Brackets and Rates. In 2021, as the Covid recession was causing tax revenue shortfalls, the legislature and governor added two high-end brackets to the state's PIT rate table along with higher rates in some of the

pre-existing brackets. Rather than a top rate of 8.82 percent on taxable income of \$2,155,150, the new table has a top bracket starting at \$25 million with a rate of 10.9 percent. These changes were expected to add \$2.7 billion in state fiscal year 2021-2022 and \$4.5 billion by 2024-2025.

The new high brackets were scheduled to expire after tax year 2025, but the Governor has proposed extending them through tax year 2032. Previously the Division of the Budget had assumed that the higher brackets would be removed as originally scheduled, resulting in lower projected PIT revenue in later years. Extending the current structure through 2032 maintains that revenue flow which DOB has estimated at \$5.0 billion. Notably, while the Governor has proposed keeping these high-earner rates and brackets in place for five more years, the surcharge on corporate profits that was enacted at the same time is still assumed to expire as currently scheduled in 2027.

At the time the PIT and corporate tax increases were enacted there was widespread concern that the New York State tax burden – particularly if New York City's taxes are taken into account – had reached a point where the rates were enough of a burden that high-income taxpayers and companies would speed up the already high out-migration from the city and state. Dislocations caused by Covid have disrupted some of the traditional data sources used to address these questions. However, recent data shows that those leaving the city were disproportionately households earning \$100,000 or less – presumably driven to relocate due to New York's high living costs - and that the number of high-income taxpayers had stayed relatively constant as high-income out-migrants were replaced by in-migrants and existing city residents with growing incomes while the 2021 tax increases remained in effect. This suggests that the State can safely extend the PIT surcharge structure and use the revenue to address its structural imbalance.