STRONG
ECONOMY
FOR ALL
COALITION

NEW YORK STATE LEGISLATURE

Senate Finance Committee
Assembly Ways & Means Committee

Senator Catherine Young, Chair
Assembly Member Herman Farrell, Chair

HEARINGS ON THE 2017-18 EXECUTIVE BUDGET PROPOSAL: TAXES

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Good morning Senator Young and Assembly Member Farrell and members of the Committee. My name is Michael Kink, and I serve as the Executive Director of the Strong Economy for All Coalition. Thank you for the opportunity to present testimony today.

Strong Economy for All is a labor-community coalition working on issues of economic fairness, jobs, income inequality and effective government policies to promote broad prosperity.

We are made up of some of New York's most engaged and effective unions and community organizations, including SEIU Locals 1199 and 32BJ; the United Federation of Teachers, New York State United Teachers and the Professional Staff Congress of CUNY, NYSUT; the Retail, Wholesale and Department Store Union and the Communication Workers of America; the New York City Central Labor Council, the Municipal Labor Committee and the state AFL-CIO; and community groups including the Coalition for the Homeless, Citizen Action of New York, Make the Road New York, New York Communities for Change and the Alliance for Quality Education.

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Strong for All was established to fight for policies and programs that will address New York's worst-in-the-nation income inequality, and we'd like to say clearly and directly that fair-share tax policies are essential to addressing economic inequality in New York, properly funding needed investments in our future, and assuring broader prosperity for all New Yorkers.

THE "MILLIONAIRES' TAX" – EXTEND & EXPAND

We worked hard in 2011 to build broad public support for the Millionaires Tax, and that public support has only grown stronger in the years since. As you know, the incomes of the highest-earning filers in New York have soared in the past decade, while our tax brackets remain linked to income distributions of the 1970s and 1980s.

It's time to update New York's Personal Income Tax structure to require more from those most able to pay: the millionaires and billionaires at the very top.

We strongly support the Assembly Majority plan recently announced by Speaker Carl Heastie that would set new Personal Income Tax brackets at income levels of $1 million, $5 million, $10 million and $100 million per year, raising $2.3 billion per year for New York needs, including public schools, lifesaving health care, affordable housing and a 21st-century clean-energy transportation and power infrastructure.

(In fact, we recommended exactly this progressive, fair-share bracket structure in last year's testimony to these committees.)

New York's super-rich choose to live here because of business, investment and cultural opportunities not offered anywhere else in the world.

The "Knight Frank Wealth Report," a world guide to prime property and wealth, continues to place New York at the very top of the global cities most attractive to Ultra High Net Worth Individuals (UHNWIs).

Last year's report put New York City number one in the current number of UHNWIs (those with $30 million in investible assets not counting their primary residence), ahead of London, Hong Kong, Singapore and Shanghai.[1]

The Wealth Report includes detail on millionaires and multi-millionaires living just in New York City:

- 320,000 Millionaires (over $1 million in wealth not including primary residence)
- 14,300 Multi-Millionaires (over $10 million)
- 5,600 UHNWIs (over $30 million)

The number has grown since New York instituted our Millionaires Tax, and Knight-Frank predicts it will grow by 29% by 2025.

Knight-Frank also predicts a dramatic increase in the number of wealthy individuals living in New York and working in the Technology and Information sector – while they see employment in finance and real estate increasing 5.4% here over the next five year, they predict a 21% increase in high-income tech jobs.[2]

[1] http://www.knightfrank.com/wealthreport/2016/wealth-movements/uhnwi-city-hubs
[2] http://www.knightfrank.com/globalcities/2017/new-york-real-estate

Knight Frank predicts that New York City will be the number-one city worldwide for UHNWIs in 2025, far ahead of cities, states and city-states that tax residents at far higher rates than we do.[3]

New York has room to tax billionaires and millionaires fairly and appropriately and remain very attractive in terms of property, business and culture.

There's no reason to hold back for fear of fleeing millionaires and billionaires, particularly when academic studies repeatedly demonstrate that UHNWIs and HNWIs don't make decisions based on incremental changes in state tax policy.[4]

CLOSE THE CARRIED INTEREST LOOPHOLE AT THE STATE LEVEL

The Strong Economy for All Coalition urges the Legislature to take action to repatriate revenue lost to the federal-level carried interest loophole and bring it to New York for new investments in schools, jobs, housing, clean energy infrastructure and essential government services. We urge passage of legislation introduced by Assembly Member Jeffrion Aubrey and Senator Jeff Klein to close the loophole, and incorporation of its language into this year's state budget.

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[3] http://www.knightfrank.com/wealthreport/2016

[4] https://web.stanford.edu/group/scspi/_media/pdf/pathways/summer_2014/Pathways_Summer_2014_YoungVarner.pdf

New York and other states stand to gain hundreds of millions of dollars acting where the federal government has failed—by closing the carried interest loophole.

Elected officials on both sides of the aisle have called for closing something known as the “carried interest loophole,” a legal fiction used by wealthy financiers to lower their federal tax rates below those paid by many working Americans.[5]

According to the New York Times,

> Partners at private-equity firms and hedge funds typically treat a big portion of the fees they charge their clients as a capital gain — that is, as profit on the sale of an investment — so they can pay tax at the capital-gains rate of 20 percent (plus a surtax of 3.8 percent typically). Ordinary income is taxed at a rate of up to 39.6 percent. But labeling fees as capital gains is a stretch, in part because the partners generally earn their fees by managing other people’s money, not by investing their own.[6]

[5] http://www.usatoday.com/story/opinion/2015/09/15/hedge-fund-carried-interest-donald-trump-jeb-bush-editorials-debates/72268922/
[6] http://mobile.nytimes.com/2016/03/11/opinion/new-york-challenges-a-tax-privilege-of-the-rich.html?_r=0

Closing the loophole would save the federal government an estimated $18 billion per year, according to an analysis by law professor Victor Fleischer.[7]

State legislatures could pass legislation to tax the carried interest income of hedge fund and private equity partnerships headquartered in their respective states at the rate of ordinary income.

Using a conservative methodology for estimating the potential annual revenues, we project that state action could recapture hundreds of millions of dollars.

In states like New York, Massachusetts, and California, the estimated income to be gained by taxing carried interest at the state level is enormous.

New York's private equity and hedge funds are conservatively estimated to be earning $35.7 billion per year in under-taxed carried interest. A state bill to recapture this revenue at the ordinary income level would add an estimated $3.5 billion additional dollars to New York's coffers.

Even states with significantly smaller hedge fund and private equity sector would stand to recapture millions of dollars per year.

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[7] http://www.nytimes.com/2015/06/06/business/dealbook/how-a-carried-interest-tax-could-raise-180-billion.html?_r=0

What is the carried interest loophole?

Simply stated, the carried interest loophole is the mistreatment of hedge fund and private equity fees as capital gains, rather than ordinary income.

Hedge fund and private equity funds are usually structured as partnerships. The fund manager is the general partner of the funds, and the investors are limited partners.

Investors often supply the majority of the capital, and the fund manager is supposed to supply investment expertise. For the services the investment manager provides, they charge certain fees.

In both hedge funds and private equity funds, the standard fee structure is "2 and 20"—two percent of the fund assets per year are taken as the management fee, which covers operating costs. Twenty percent of all gains over a certain benchmark rate are taken by the fund manager as the performance fee.[8]

The problem comes from how that twenty percent performance fee is treated for tax purposes.

[8] https://www.fas.org/sgp/crs/misc/RS22689.pdf

To an outsider, it may seem that this twenty percent fee is compensation for services. According to the Tax Policy Center, a joint project of the Brookings and Urban Institutes, the vast majority of tax analysts share this view.[9]

If we treated the performance fee as a fee for services, it would be federally taxed at the ordinary income level, where the highest marginal tax rate is currently 39.6%. Instead, many fund managers treat this fee as an investment profit.

Profits on investments held longer than one year receive preferential treatment in the tax code, with the highest marginal rate on long-term capital gains set at 20%.[10]

That difference of 19.6% may not sound like a lot of money, but the academics estimate the tax revenue loss from the carried interest loophole to be $18 billion per year nationwide – and $3.5 billion for New York.

The Strong Economy for All Coalition urges the Legislature to take action to repatriate revenue lost to the federal-level carried interest loophole and bring it to New York for new investments in schools, jobs, housing, clean energy infrastructure and essential governments services.

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[9] http://www.taxpolicycenter.org/briefing-book/key-elements/business/carried-interest.cfm
[10] Plus a 3.8% Medicare surtax