



Testimony to

**Senate Finance Committee and Assembly Ways and Means
Committee**

FY 2020 Executive Budget: Taxation and other Business Issues

Presented by

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My name is Ken Pokalsky and I am Vice President of The Business Council of New York State, Inc. We are New York's largest statewide employer association, representing 2,400 private sector employers across New York, in all major business sectors.

As always, we appreciate this opportunity to address members of the Senate Finance and Assembly Ways and Means Committee on the Executive Budget.

In our testimony today, I intend to focus on the major tax policy provisions in the FY 2020 Executive Budget. We will briefly address several additional Executive Budget provisions that, while not tax legislation *per se*, would have a significant impact on the state's private sector and its overall business climate.

OVERVIEW - The Business Council has supported Governor Cuomo's overall approach to fiscal management, which is reflected in relatively low year-to-year growth in state spending. This spending restraint has allowed for both middle class personal income tax reductions and the reform and reduction of some business taxes. In addition, the real property tax cap has saved taxpayers overall an estimated \$10 billion since its enactment, including almost \$2 billion for business taxpayers.

When the Executive Budget was proposed on January 15, its projections showed that the continuation of a 2 percent spending growth target, coupled with the re-extension of the state's top personal income tax for another five years, would help balance the FY 2020 budget, largely close the projected structural budget deficit in FY 2021, and generate budget surpluses for FY 2022 and 2023. This continued approach to fiscal management would leave New York in a much better fiscal condition than many other states.

However, last week's joint announcement by Governor Cuomo and Comptroller DiNapoli raised serious concerns about those projections, and about future budget outcomes.

It showed that estimated personal income tax payments in December and January fell by \$2.3 billion more than recently forecasted— an outcome that we expect is largely based on the poor performance of investment markets in 2018, and the resultant lowering of capital gains, and also in part the result of some taxpayer changes in response to the federal cap on SALT deductions.

On the other hand, wage withholdings were actually above projections for December and January, showing an underlying strength in the economy, with both jobs and wages up.

Even so, we believe the recent income tax figures provide a cautionary message for the state legislature:

- Last year's market volatility was in response to several major ongoing risks to future U.S. economic performance, suggesting that legislatures should act cautiously on proposals to significantly increase spending or impose new taxes on an economy showing slower growth rates.
- The significant falloff in estimated personal income tax payments is also another reminder of the risks inherent in the state's growing reliance on high earners for overall income tax revenues and year-to-year revenue increases that allow for new spending initiatives. It is ironic that, despite the Administration's concerns about the loss of tax revenues from the state's highest earners, the Executive Budget includes two provisions specifically targeting them for continued high taxes and new tax surcharges. (We also note that new legislation has been introduced – S.3246 (Gianaris)/A.2743 (O'Donnell) – that would impose a new surcharge on high earners under the New York City income tax.

These factors add to the Legislature's annual challenge in composing a final state budget. The following provides our comments on specific components of the Executive Budget and raises several additional issues for consideration during the ongoing budget negotiations.

EXECUTIVE BUDGET TAX ISSUES

"Millionaires Tax" – The Executive Budget proposes to extend the current top 8.82 percent personal income tax rates – currently set to expire at the end of the 2019 tax year – for another five years. We fully expect this proposed extension to be adopted, however we note that based on the Executive Budget's projected fiscal plan, full extension is not required to meet the state's constitutional mandate for a balanced budget.

Given the high level of concern about the impact that federal cap on state and local tax deductibility will have on state PIT receipts from its highest earners, the state should strongly consider modifying this extension proposal, by limiting either its rate or its duration, to more closely match the state's projected revenue needs.

In addition, as part of its review of the state's personal income tax structure, the Legislature should also consider several proposals to address the tax burden imposed on small business. Previously, both houses of the legislature, and the Administration, have advanced legislation to increase the exemption percentage business-related income earned by non-incorporated ("pass-thru") small businesses under the state's personal income tax. In addition, the legislature should consider legislation that provides a reduced income tax rate for non-incorporated manufacturers under the personal income tax - see S.1596 (O'Mara/A.636 (Stirpe)).

Marketplace Providers – Given the U.S. Supreme Court's decision last June in *Wayfair v. South Dakota*, it was expected that New York would act – as a majority of states have – to impose sales tax collection obligations on out-of-state vendors with no physical nexus with New York (Since *Wayfair*, of the forty-five states that impose a general sales and use tax, forty-one have previously either passed legislation, enacted an administrative rule, or have a pending proposal for economic nexus.) The Executive Budget's "marketplace provider" proposal (S.1509/A.2009, Part G) should provide an efficient and effective means to do so.

Interestingly, while the Executive Budget proposal is seen as meeting one of the key "tests" set forth in *Wayfair*, i.e., reducing administrative and compliance costs for out-of-state taxpayers, it fails to meet another test regarding a reasonable safe harbor provision for transacting limited business in the state (as the Executive Budget would require marketplace providers to collect sales tax on behalf of all vendors, regardless of their number or value of transactions in New York State.) This approach is also inconsistent with the policy set forth in a January 15, 2019 Tax Department guidance memo effectuating long-standing "economic nexus" provisions in the state's sales tax law (see Tax Law sections 1101(b)(8)(i)(E) and 1101(b)(8)(iv)) that are dependent on ". . . satisfy[ing] the nexus requirement of the United States constitution." Those sales tax provisions only apply to vendors with 100 transactions and \$300,000 in receipts over a four-quarter period. The Tax Department guidance also stated that this determination was effective immediately upon issuance of the *Wayfair* decision, even though the policy statement was not issued until six months later, raising compliance questions among out-of-state vendors. The January 15 guidance also raises concerns about retroactive application of the tax law. If the legislature is going to act on this issue of economic nexus, it should adopt a consistent approach that addresses the full range of factors raised in *Wayfair*.

TCJA Decoupling - For many states, including New York, the starting point for calculating state-level business and personal income taxes is the federal tax code. In general, the federal Tax Cut and Jobs Act of 2017, or TCJA, expanded the federal definition of income, but provided significant rate

reductions, providing lower tax liability for many individual and business taxpayers at the federal level. As result, many states' tax laws automatically reflected the broadened federal definition of income, but not federal the rate reductions or credits, resulting in INCREASED state-level tax liability.

New York, like many states, have responded by acting on "decoupling" legislation. In the FY 2019 state budget, New York approved several provisions designed to avoid increased state-level tax liability for New York State individual and business taxpayers. However, several significant issues still need to be addressed in the 2019 legislative session.

Key additional decoupling issues include:

- the TCJA imposes ongoing federal taxation of "global intangible low tax income" or GILTI, which is calculated based on a complex formula, and represents income earned abroad but not actually paid to a domestic parent company. Even so, this amount will be added to federal taxable income, and will flow through to state business tax returns. We strongly support, and urge the legislature to adopt, an exemption for GILTI under state and New York City business taxes.

- the TCJA capped the deduction of business interest expenses at 30 percent of business income, but in exchange allowed a five-year period where business could immediately deduct (or expense,) rather than depreciate, most capital investments. New York is already decoupled from federal bonus depreciation, but New York business taxpayers will be subjected to higher state tax liability due to the state's automatic acceptance of the interest deduction cap, which will even apply to expenses related to capital investments made before adoption of TCJA. New York should decouple from the federal cap.

In general, the state had projected limited significant additional revenues from these provisions, so amendments adopted in the 2019 session should not adversely impact the state's long-term financial plans.

However, these conformity issues will be an economic competitiveness issue for New York and other states. Given the Administration and legislature's focus on avoiding unintended tax increases due to TCJA, these issues should also be addressed during the 2020 budget process.

In addition, we support the two-business tax decoupling provisions included in the Executive Budget. The first addresses the potential impact of TCJA provisions on a taxpayer's status as a qualified New York manufacture, and therefore its eligibility for beneficial tax rates and real property tax credit. (S.1509/A.2009, Part D). The second decouples from TCJA's treatment of "contributions to capital" from state and local sources, including state capital grants and other forms of economic development assistance, which would be counted as taxable income for federal tax purposes. New York State should decouple from this federal provision to avoid reducing the value of state-provided economic development incentives. ((S.1509/A.2009, Part X).

Other Executive Budget Tax Issues – The Executive Budget contains several other proposed Tax Law changes. We will address several of the more significant ones here.

We support:

- the permanent extension of the real property tax cap (S.1505/A.2005, Part G).
- the proposal to extend through June 30, 2021 the sales tax exemption for transactions between related entities that are required by federal Dodd-Frank legislation (S.1509/A.2009, Part V)
- if the legislature votes to legalize recreational cannabis, it makes sense to adopt the Executive Budget proposal to impose taxes on its cultivation and sale. Revenue projections

from legalized cannabis is estimated to increase to \$184 million by FY 2024. (S.1509/A.2009, Part WW)

- Many employers provide day care services for their employees, but this benefit has become increasingly expensive with mandatory wage increases and other factors. To make this benefit more affordable, we support the proposal to adopt a new 25 percent refundable tax credit against employers' cost of providing employee day care services (capped at \$150,000 per employer) (S.1509/A.2009, Part L)

- On an issue not addressed in the Executive Budget, we strongly support the extension of the minimum wage tax credit which expired at the end of 2018. This is a refundable credit of \$1.35 per hour, applicable only for employees that are between the age of 16 and 19 years old and enrolled in school. This tax credit promotes the hiring and retention of relatively low-skilled workers.

We oppose:

- a recurring proposal to impose a 17% surcharge on newly defined "investment management services," with these provisions to become effective when and if substantially similar legislation is adopted by Connecticut, New Jersey, Massachusetts and Pennsylvania (so far, only New Jersey has done so). This legislation is intended to counteract the federal "carried interest loophole," under which income from certain investment management services is treated at capital gains rather than ordinary income. Importantly, no such distinction exists under the state's personal income tax, meaning that there is no such "loophole" under state law. In effect, this bill would penalize certain high-income New York taxpayers based on provisions of federal tax law. We believe this surcharge would be an effective incentive to move these activities out of New York State and neighboring states. The Executive Budget projects no immediate revenue impact, so this legislation is not necessary to implement the FY 2020 state budget. (S.1509/A.2009, Part Y)

- the authority for the Department of Transportation to charge fees on private fiber optic companies that occupy state rights-of-way. The longstanding practice of locating communications infrastructure along state roads has benefited New York through the expansion of in-State communications capacity. Dating back to the early 20th century, telephone and telegraph lines had the legislated right to occupy state highway right of ways free from use and occupancy fees. This public policy encouraged expansion of communication networks and will support the expansion of fiber optics. The proposal to charge right of way fees runs contrary to publicly stated and roundly touted efforts to provide broadband for all New Yorkers. Charging fiber optic companies an estimated \$195 million over five years through right-of-way fees runs contrary to established state policy and diverts funds from expansion of broadband and other infrastructure upgrades.

- the Executive Budget proposal to extend sales tax on the transportation, transmission, delivery of gas or electricity purchased through an energy service company. This measure would impose an estimated \$128 million in new state-level taxes on energy purchases in New York State, if local governments follow suit, by eliminating the local sales tax exemption, the cost of this proposal could be almost double that amount. We do not believe this proposal supports any compelling tax policy issue; instead it would increase the cost of energy to New York State businesses and be in addition to significant additional energy assessments imposed by the Public Service Commission. (S.1509/A.2009, Part H).

EXECUTIVE BUDGET NON-TAX ISSUES - As is often the case, several of the most significant proposals in the Executive Budget are not strictly budget-related. While the focus of today's hearing is the taxation provisions of the Executive Budget, we would like to identify several of the most

important non-tax issues in our testimony today and will be providing members of the legislature with additional information on these issues.

Universal Coverage - We support the Executive Budget provision to create a "Commission to Evaluate Options for Achieving Universal Access to High-Quality, Affordable Health Care in New York", an effort that will engage independent health policy and insurance experts. The commission will consult with the legislature and stakeholder groups and members of the public to review and discuss options for achieving universal access to health care and provide a report to the Governor by December 1, 2019. Perennial legislation for government-run healthcare lacks crucial, specific details. One thing is clear, however — a quarter trillion-dollar price tag and 150,000 lost jobs are far too steep a sacrifice to undo the current system and switch to a single payer plan to extend cover to the less than 5 percent of uninsured New Yorkers. The Business Council believes that there are far better solutions and supports Governor Cuomo's budget proposal to conduct a comprehensive, fact-based study on how to properly address the issue of uninsured New Yorkers. (HMH Article VII Part N)

Climate change provisions – The proposed Climate Leadership Act has three main components. It create a Climate Action Council, with limited public members, to make recommendations to reduce all GHG emissions by 40 percent by 2030 and 80 percent by 2050, from 1990 level; it requires the Department of Environmental Conservation to, within 2 years, to issue statewide greenhouse gas limit equal to a 40 percent reduction by 2030, and to begin proposing implementing regulations within four years; and it requires all Load Serving Entities (LSE) to meet 100 percent of demand with "clean energy sources" by 2040. It also directs DEC to establish a social cost of carbon. While The Business Council supports the state's overall goal of reducing greenhouse gas emissions, this legislation would impose significant additional costs on the state's economy, and likely result in the shift of energy-intensive activity to less-carbon-efficient jurisdictions. (S.1508/A.2008, Part X).

MWBE extension – The Business Council and its members support the intent of Article 15A to promote participation by minority and women-owned businesses in the state contracts. However, we strongly recommend that reauthorization include meaningful reforms that makes the program more flexible and workable. The Executive Budget proposal as it fails to address basic concerns raised by state contractors, and instead makes the program even more difficult to manage. Key concerns are: a lack of transparency in the setting of contract-specific participation targets; reliance on a 2016 Disparity Study (released to the public in June of 2017) with unrealistic MWBE capacity determinations; and others.

Prevailing wage extension – The recent state of the state/Executive Budget message included support for legislation – not included in the Executive Budget – to impose public works prevailing wage mandate on projects receiving state or local economic development assistance. The legislature has considered similar legislation the past several sessions (e.g., S.1947 (Ramos)/A.1261 (Bronson)). This bill simply runs counter to the state's efforts to promote private sector capital investment in all parts of New York, especially upstate where many counties have seen flat economic growth. Driving up project labor costs will hamper a wide range of employers and development projects, including for-profit businesses as well as non-profit service providers on which our communities rely.

Bottle bill expansion - The Business Council of New York State opposes the proposal to expand the Bottle Deposit Law to cover juices, teas, sport drinks, cold coffee drinks, non-alcoholic cider and other new age beverages. The bottle deposit law duplicates curbside collection programs, is costly, removes valuable materials from municipal recycling programs, and burden small retailers. (S.1508/A.2008, Part F).

Workplace Impairment – The Business Council has taken no position on the threshold public policy issue of legalization of recreational use of cannabis. However, we are concerned that the proposal would place a significant burden on the employer to demonstrate the employee's impairment as a

result of the use of cannabis that goes well beyond what is required regarding other intoxicating substances. In order to take any action in response to concerns about workplace impairment, this section would require the employer to establish that cannabis use has decreased or lessened the employee's ability to perform specific job duties and manifests certain "articulable symptoms" of impairment. This proposed language will compromise an employer's obligation to maintain a workplace free from hazards, including those resulting from employee impairment, thereby also impairing the employer's rights and obligations to protect the safety and well-being of employees and customers alike. Any level of workplace "impairment" should be sufficient to warrant employer action. Both New York State occupational safety laws and the Federal Occupational Safety and Health Act require employers to maintain a safe and healthful workplace free from recognized hazards. Creating a separate and significant employer burden for addressing cannabis impairment will interfere with an employer's obligation under OSHA's General Duty Clause.

Mandatory Unionization – As part of its recreational cannabis provisions, the Executive Budget proposes that all entities licensed to cultivate, process, distribute and sell adult-use cannabis and who employ 25 or more employees are required to enter into a collective bargaining agreement with a bona-fide labor organization. We believe this mandate is inconsistent with federal law, and it is therefore beyond the state's legal authority to impose such a mandate. The National Labor Relations Act forbids employers from interfering with, restraining, or coercing employees in the exercise of any rights relating to organizing, forming, joining or assisting a labor organization for collective bargaining purposes, or from working together to improve terms and conditions of employment, or refraining from any such activity. Similarly, labor organizations may not restrain or coerce employees in the exercise of these rights. Aside from these legal issues, we question the policy aspect of mandating that employees join a union and pay union dues, regardless of their individual choice.

Our testimony today focuses on tax related elements of the Executive Budget. The Business Council has interest in these, and other spending and policy proposals contained in the Executive Budget, and will be sharing our additional budget issues and recommendations with Senate and Assembly members in the coming days.

Thank you again for the opportunity to testify today, and I welcome any questions or comments you have on these or other tax policy issues.

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