Impact of 2002 Stimulus Act on New York City Tax Revenues: Background and Estimation

The "Job Creation and Worker Assistance Act of 2002," often referred to as the "Stimulus Act" was signed by the President on March 9. The legislation contains a number of provisions that—barring adjustments by New York City—will have a direct affect on the city's tax revenue.[1] IBO estimates that the direct revenue losses for the city will be $93 million in fiscal year 2002, $204 million in 2003, $169 million in 2004, $191 million in 2005, $188 million in 2006, and $42 million in 2007. After 2007, the direct impact would turn positive, with the gain to the city averaging a bit less than $50 million per year.

Link Between Federal and City Taxes. The losses will occur because the city's four income taxes (general corporation tax, banking corporation tax, unincorporated business tax, and personal income tax) are closely linked to corresponding taxes at the federal level. For each of these taxes, calculation of city tax liability begins with federal taxable income. The stimulus bill has several provisions designed to stimulate economic activity by allowing firms extra deductions if they make investments in certain types of new business equipment and buildings. The larger deductions lower the company's net income, which in turn lowers their federal tax liability. The lower net incomes flow through to city tax calculations, resulting in lower city tax liabilities as well.

Although most of the lost revenue will be from the city's GCT and BCT, the other two city income taxes will be affected as well. The city's UBT is imposed on partnerships and sole proprietorships based on their portion of net income allocated to the city. For partners and proprietors of UBT-paying firms who reside in the city, the income that is disbursed to them from their businesses is also subject to the city's personal income tax. Thus, investment by unincorporated businesses that qualifies for the stimulus bill's larger deductions will result not only in lower city UBT revenues, but also in lower city PIT revenues. At the federal level unincorporated business income is not taxed at the entity level. Income generated by such businesses is only taxed on the federal personal income tax.

Depreciation Changes. The change with the largest direct impact on city revenues modifies the deduction for depreciation in the first year of a newly acquired asset's useful life. In the federal income tax system businesses are allowed an annual deduction to account for the declining value of an asset as it ages. The consumption of an asset's value is known as depreciation. The rate at which an asset can be depreciated varies depending

---

[1] The legislation also includes a wide-ranging mix of provisions designed to help sustain and stimulate the U.S. economy and to help with the recovery of lower Manhattan, which will likely result in higher city tax revenues from induced economic activity. These include the extension of unemployment insurance for an additional 13 weeks nationwide, a $2,400 per worker federal tax credit for jobs retained or relocating downtown, and the grant of $8 billion in private-activity tax-exempt bonding authority for the city to support downtown rebuilding. The legislation also provided some direct budget relief to the city by permitting an additional refinancing of certain qualifying tax-exempt bonds issued by the city and other New York public entities.

upon the type of good. The formulas and rules for computing depreciation for tax purposes are spelled out in the Internal Revenue Code (IRC).[2]

Under the IRC a set of depreciation rules known as the Modified Accelerated Cost Recovery System (MACRS) has been in place since 1986. Under MACRS, most tangible property exclusive of real property has a recovery period of 3 to 20 years.[3] The Stimulus Act creates a bonus depreciation deduction of 30 percent for the first year of an asset's useful life. The bonus is available for all qualified investment in tangible property other than real property anywhere in the U.S., provided the asset is acquired between September 11, 2001 and September 10, 2004.

To see the extent of the benefit offered by the stimulus act consider the following example. Under prior law, a company purchases a $1 million piece of production equipment which has a seven-year recovery period, and is entitled to a deduction from its taxable income of $142,900 in the first year.[4] Under the Stimulus Act, the corporation receives a bonus deduction of $300,000 (30 percent of the initial value of the machine) in the first year. The bonus deduction reduces the basis to be depreciated using regular MACRS rules to $700,000, so that the first year MACRS deduction is $100,000, bringing the total first-year deduction to $400,000 or $257,100 more than it would have been without the bonus. In subsequent years, the deduction is smaller than it would have been because the depreciable basis was reduced by 30 percent.

The Joint Tax Committee of the Congress has estimated that the bonus deduction will reduce federal tax revenues (corporate and personal income taxes combined) by $35.3 billion in federal fiscal year 2002, $32.4 billion in 2003, and $29.2 billion in 2004. Thereafter, the provision begins to result in additional revenue, primarily because the 30 percent bonus deduction lowers the depreciable basis of assets for firms taking the benefit. The Joint Tax Committee estimate also assumes that the bonus will shift the timing of some investment decisions forward.

The following table shows IBO's estimate of the effect of the 30 percent bonus on city tax revenues. (See below for methodology.)

	City Fiscal Years					
	2002	**2003**	**2004**	**2005**	**2006**	**2007**
GCT+BCT	-71.2	-65.3	-58.8	0.3	38.2	36.8
UBT	-30.4	-27.8	-25.1	0.1	16.3	15.7
PIT	-12.1	-11.1	-10.0	0.0	6.5	6.3
Total	-113.7	-104.2	-93.9	0.4	61.0	58.8
Half of 2002 cost	-56.9					

[2] Changes in the treatment of depreciation has been used before as a tool of fiscal policy, including during World War II, in the 1962 Kennedy tax cut, and in the 1981 Reagan tax cut.
[3] Real property is depreciated under a set of rules different from MACRS; residential income-producing buildings generally have a 27.5-year recovery period and non-residential buildings have a 39-year recovery period. Land can not be depreciated.
[4] This was computed using the 200 percent declining balance method and followed the mid-year convention.

Liberty Zone Benefits. The other provisions in the legislation that will have a direct impact on city revenues are all confined to the Liberty Zone in lower Manhattan. The zone is essentially the area south of Canal Street.

- There is a separate 30 percent depreciation bonus for investments within the zone. The window for investment is longer (through December 31, 2006) and the types of assets which can qualify is broader, including real property replacing buildings destroyed or condemned as a result of the September 11 attack, as well as leasehold property not normally eligible for MACRS. A taxpayer can only use one 30 percent bonus on each asset.
- The amount of qualifying investment that can optionally be fully expensed in the first year (i.e. the cost is fully deducted in one year rather then using depreciation over the recovery period) is increased from the prevailing $25,000 to $35,000. To qualify, the investment must be for use inside the Liberty Zone and be put in place by December 31, 2006.
- The period during which a taxpayer does not have to recognize gain when property that was involuntarily converted is replaced is extended from two years to five years. Only property affected by the September 11 attacks is eligible.

The Joint Tax Committee's estimate of the federal revenue impact for those provisions with a direct effect on New York tax revenues is $318 million in federal fiscal year 2002, $433 million in 2003, and $1,083 million by 2006. The impact from the provisions begins to decline in federal fiscal year 2007. Starting in 2010 and thereafter, the provisions are expected to result in federal tax revenues above baseline projections, again because the 30 percent depreciation bonus lowers the depreciable basis of assets for firms taking the benefit. The impact for federal taxes stays negative for five additional years because the window for qualifying investments is longer.

The following table shows IBO's estimates of the effect on New York City income taxes from the Stimulus Bill's Liberty Zone provisions having a direct impact on net income allocated to the city.

	2002	2003	2004	2005	2006	2007
GC+ BCT Impact	-63.3	-86.2	-64.9	-165.8	-215.5	-87.2
UBT Impact	-6.9	-9.5	-7.1	-18.2	-23.7	-9.6
PIT Impact	-2.8	-3.8	-2.8	-7.3	-9.5	-3.8
Total	-73.0	-99.4	-74.8	-191.2	-248.6	-100.6
Half of 2002 cost	-36.5					

Estimating Methodology

IBO's estimates are largely based on the federal tax impacts published by the Joint Tax Committee on March 6 ("Estimated Revenue Effects of the 'Job Creation and Worker Assistance Act of 2002,'" JCX-13-02). The New York City impacts were estimated by sharing-down the federal estimates based upon the relationships between the city and federal tax bases.

Estimate of General 30 percent Depreciation Bonus. We began by allocating the federal impact to a portion affecting the federal corporate income tax and a portion affecting the federal personal income tax. The allocation was based on analysis by the Senate Budget Committee showing that 78.9 percent of the tax expenditure resulting from the standard MACRS depreciation deduction was by corporate taxpayers. (*Tax Expenditures: Compendium of Background Materials on Individual Provisions*, Committee Print, 106th Congr., 2nd sess., p. 243.) The resulting corporate portion was then shared down by using sectoral shares of 1998 depreciation deductions (IRS SOI 1998 Corporate Income Tax Returns, Table 1, available at www.irs.gov/taxstats) weighted by the ratio of New York City GCT liability (NYC Dept. of Finance Office of Tax Policy 1998 GCT/UBT Report) to federal corporate tax liability in each sector. Because the federal corporate tax applies to banking corporations as well as general corporations, we added the city BCT liability to the finance sector in the city's corporate tax liability distribution. This weighting adjustment accounts for the differences in the distribution of liability by sector, as well as the distribution of depreciation by sector, between the city tax and federal tax bases.

For the UBT impact, a similar share-down was done for the portion of the full federal impact assumed to come from the federal personal income tax (21.1 percent of the total). Rather than liability distributions by sector, we used net income by sector (with no partnership income tax on the federal level, there is no tax liability to compare) for partnerships. The UBT data came from the same Office of Tax Policy as above. Federal data on partnership income and depreciation deductions by sector came from IRS SOI 1998 Partnership Returns data available at www.irs.gov\taxstats.

The city PIT impact was shared down using the same approach used for the UBT. To account for the fact that many partners in city UBT taxpaying firms are not city residents, the PIT estimate was reduced by half.

Estimate of Liberty Zone Provisions. The impact of the Liberty Zone provisions was estimated as a set rather than individually. The same allocation of the full federal impact into corporate and personal taxes was used. The allocated amounts were then shared-down for the GCT/BCT, the UBT, and the PIT using the same methodology as above.

First-year Timing. The Joint Tax estimates show the provisions having a full effect in the FFY2002, which runs from October 1, 2001 through September 30, 2002. This implies that firms will very quickly adjust their estimated tax payments to take advantage of the benefits and that the stimulative effects will quickly induce new investment. Because the city's 2002 fiscal year began three months earlier on July 1, 2001, the impact for CFY2002 will be less than the full-year value. Our estimate reduces the first-year impact of both the depreciation changes and the liberty zone benefits by 50 percent.