OPTION:

Collect PILOTs for Property Tax Exemption for College Student, Faculty, and Hospital Staff Housing

Revenue: $128 million annually if applied to student, faculty, and hospital staff housing

Under New York state law, real property owned or used by private higher education institutions and hospitals is exempt from the city's real property tax. In fiscal year 2016, these exemptions cost the city $1 billion—a $483 million tax expenditure for higher education and a $599 million one for hospitals.[1] At universities and hospitals, exemptions for student, faculty, or staff housing represented 18 percent ($194.6 million) of the total. Under this option, private colleges and universities in the city would make payments in lieu of taxes (PILOTs), either voluntarily or through legislation.

There are various ways a PILOT system could be structured based on experiences in other jurisdictions. In Boston, private universities and hospitals make voluntary PILOTs. In contrast, Connecticut law mandates that the state provide PILOTs to municipalities up to 77 percent of private universities' and hospitals' exempt value. A third alternative is a "reverse PILOT," which the Connecticut legislature debated in 2014 but did not implement. Under this proposal, the organizations' property tax exemptions would be eliminated, and they would have to apply to the state for reimbursement. If universities and hospitals made PILOTs equal to 66 percent of their liability, the city would receive $714 million for all exemptions, or $128 million if applied only to housing for students, faculty, and staff.

Proponents might argue that colleges and universities consume city services without paying their share of the property tax burden. With respect to housing facilities specifically, proponents could contend that housing is not directly related to providing education or medical services. Instead, housing is an optional service organizations elect to provide. Finally, proponents might point to several other cities that collect PILOTs, including large cities such as Boston, Philadelphia, New Haven, and Hartford and smaller cities such as Cambridge and Ithaca.

Opponents might argue that colleges and universities provide employment opportunities, purchase goods and services from city businesses, provide an educated workforce, and enhance the community through research, public policy analysis, cultural events, and other programs and services. Opponents also could argue that the tax exemption on faculty and staff housing encourages residence and consumption of local goods and services, thereby generating income tax and sales tax revenue.

[1]There is little incentive to assess exempt properties as accurately as possible. If these options are implemented and payments are based on assessed value, the estimated PILOTs might change significantly.

OPTION:

Eliminate the School Bus Operation Deduction

Revenue: $1 million annually

Income derived from the operation of school buses serving public schools and nonprofit religious, charitable, and educational organizations, either in or outside the city, is not currently taxable for general corporation tax (GCT) purposes. This option would make this income taxable, thereby increasing GCT revenue by an estimated $1 million a year. Eliminating this tax break requires state legislation.

Proponents might argue that in addition to raising revenue that would offset a small part of the city's costly bill for school bus services, this option would eliminate an unfair tax break to school bus contractors. They would point out that the majority of private companies providing goods and services to public schools and nonprofits pay taxes on the income derived from sales to these entities. They might also argue that the number of school bus companies providing services would not be adversely affected by the elimination of the tax break because New York City's demand for school buses is strong enough to attract multiple competitors when contracts are bid. Finally, they might argue that there is no need for New York City to provide a tax break to companies serving public school districts and nonprofits outside of the city.

Opponents might argue that school buses are required by many schools and nonprofits to conduct their operations and, therefore, companies providing bus service should be treated like a government entity or nonprofit for tax purposes. They might also argue that the tax placed on this income will be paid, at least in part, by the government or nonprofit customer depending on the extent to which school bus operators are able to pass the tax onto their customers in the form of higher prices. If the city has to pay more for bus service, this option might have only a minimal effect on net city revenue (tax revenue less government spending). Operating costs for nonprofits may also increase, which would work against the public policy of supporting these entities through their tax-exempt status.

OPTION:

Eliminate the Property Tax Exemption For Madison Square Garden

Revenue: $42 million in 2018

This option would eliminate the property tax exemption for Madison Square Garden (MSG or the Garden). Since 1982, the Garden has received a full exemption from property tax liability for its sports, entertainment, and exposition property. Under Article 4, Section 429 of New York State Real Property Tax law, the exemption is contingent upon the continued use of MSG by professional major league hockey and basketball teams for their home games. In 2013, the Garden's owners completed a $1 billion renovation of the facility, and as a result the tax expenditure for the exemption increased from $17.3 million in 2014 to $42.4 million for 2018.

When enacted, the exemption was intended to ensure the viability of professional major league sports teams in New York City. Legislators determined that the "operating expenses of sports arenas serving as the home of such teams have made it economically disadvantageous for the teams to continue their operations; that unless action is taken, including real property tax relief and the provision of economical power and energy, the loss of the teams is likely…" (Section 1 of L.1982, c.459). Eliminating this exemption would require the state to amend this section of the law.

Proponents might argue that the city has many fiscal needs that are more pressing than sports and entertainment, and thus the exemption is a poor allocation of scarce public dollars. Moreover, proponents could argue that the historical motivation for the exemption likely no longer applies. According to Forbes, the Knick's market value is $2.5 billion, nearly five times its 2000 value (in 2015 dollars), while the Ranger's value has tripled over the same period, indicating the teams are no longer economically disadvantaged. They could also argue that the threat of relocation is much less creditable today than in 1982, not only because of the arena's recent renovation, but also because team revenue is boosted from operating in the nation's largest media market. Thus, relocating would likely cost the Garden more in revenue than it saves through the tax exemption.

Opponents might argue that the presence of the teams continues to benefit the city economically and that foregoing $42.4 million is reasonable compared with the risk that the teams might leave the city. Some also might contend that reneging on the tax exemption would add to the impression that the city is not business-friendly. In recent years the city has entered into agreements with the Nets, Mets, and Yankees to subsidize new facilities for each of these teams. These agreements have leveled the playing field in terms of public subsidies for our major league teams. Eliminating the property tax exemption now for Madison Square Garden would be unfair.

OPTION:

Eliminate the Manhattan Resident Parking Tax Abatement

Revenue: $14 million annually

The city imposes a tax of 18.375 percent on garage parking in Manhattan. Manhattan residents who park a car long term are eligible to have a portion of this tax abated, effectively reducing their tax to 10.375 percent. By eliminating this abatement, which requires state approval, the city would generate an additional $14 million annually.

Proponents might argue that having a car in Manhattan is a luxury. Drivers who can afford to own a car and lease a long-term parking space can afford to pay a premium for garage space, which is in short supply in Manhattan. Car owners contribute to the city's congestion, poor air quality, and wear and tear on streets. Elimination of the parking tax abatement would force Manhattan car owners to pay a greater share of the costs of their choice to drive.

They might also point out that the additional tax would be a small cost relative to the overall expense of owning and parking a car in Manhattan. The median monthly cost to park is $533 in downtown Manhattan, and $562 in midtown. The tax increase would be about $43 a month in downtown, $45 a month in midtown, and lower in residential neighborhoods with less expensive parking. This relatively modest increase is unlikely to significantly influence car owners' choices about where to park.

Opponents might argue that the tax abatement is necessary to encourage Manhattan residents to park in garages, thereby reducing demand for the very limited supply of street parking. Furthermore, cars are scarcely a luxury good for the many Manhattan residents who work outside the borough and rely on their cars to commute. Finally, they could argue that, at least in certain neighborhoods, residents are already paying premium rates charged to commuters from outside the city, which are higher than those charged in predominantly residential areas.

OPTION:

Establish an Unrelated Business Income Tax

Revenue: $15 million annually

This option would tax the "unrelated business income" of tax-exempt organizations in New York City—income from a regularly conducted business of a tax-exempt organization that is not substantially related to the principal exempt purpose of the organization. For example, a tax-exempt child care provider that rents its parking lot every weekend to a nearby sports stadium would be taxed on this rental income because it is regularly earned but unrelated to the organization's primary mission of providing child care.

Unrelated business income has been taxed for over two decades by both the federal government and New York State, but it is not taxed by New York City. Based on Internal Revenue Service (IRS) data on federal unrelated business income tax revenue in 2011 and local earnings data, an unrelated business income tax (UBIT) for tax-exempt entities in New York City having the same 8.85 percent tax rate as the city's general corporation tax would generate an additional $15 million annually. Establishing a city UBIT would require the approval of the state Legislature in Albany.

Proponents might argue that a UBIT would create a more level playing field when nonprofits earning income from untaxed ancillary activities compete with taxpaying businesses. Also, because a UBIT would apply only to income from ancillary activities, its burden on tax-exempt organizations is limited. Finally, because unrelated business income is already taxed at the federal and state levels, there would be few additional administrative costs incurred by either the city or the organizations subject to a city UBIT. The city would be able to use the same definition of unrelated business income as the IRS and offer many of the same deductions and credits.

Opponents might argue that many nonprofit organizations are exempt from taxes in recognition that the services they provide would otherwise need to be provided by the federal, state, or local government. Taxes paid on unrelated business income would reduce the amount of money that nonprofits can spend on the provision of services—an outcome at odds with the intent of supporting a group's services through tax-exempt status. Reducing the amount of money spent on the services provided by tax-exempt groups is particularly unwise given how many New Yorkers have been left behind in the economic recovery from the Great Recession.

OPTION:

Extend the General Corporation Tax to Insurance Company Business Income

Revenue: $437 million annually

Since the city's insurance corporation tax was eliminated in 1974, insurance companies are the only large category of businesses that are currently exempt from New York City business taxes. The Department of Finance estimated the insurance company exemption from business income tax cost the city $437 million in fiscal year 2015. Insurance companies are subject to federal and state taxation. In New York State, life and health insurers pay a 7.1 percent state tax on net income (or alternatively, a 9.0 percent tax on net income plus officers' compensation, or a 0.16 percent tax on capital) plus a 1.5 percent tax on premiums; nonlife insurers covering accident and health premiums pay a 1.75 percent state tax on premiums; all other nonlife insurers pay a 2.0 percent tax on premiums. Almost all states with insurance taxes provide for retaliatory taxation, under which an increase in State A's tax on business conducted in State A by insurance companies headquartered in State B will automatically trigger an increase in State B's tax on the business conducted in State B by companies headquartered in State A. By simply extending the city's general corporate tax to include insurance premium income rather than creating a new separate insurance tax in the city, it is likely that many of these retaliatory taxes would not be triggered. Eliminating the insurance company exemption requires state legislation.

Proponents might argue that much of the tax benefit resulting from the insurance company exemption is exported to out-of-city insurance companies that are collecting health and life insurance premiums from New York City residents. The exemption is contrary to two principles of good tax policy. First, tax credits, deductions, and exemptions should be designed to attract business that would otherwise choose not to locate in New York City. The insurance company exemption does not do much to attract business specifically to the city because companies located elsewhere also benefit from the exemption. Taxing insurance companies would put them on more equal footing with other incorporated businesses in New York City. Second, insurance companies avail themselves of public goods provided by the city and thus, should be liable to pay taxes to the city under the benefits principle of taxation. Finally, the city could also adopt a credit against insurance firms' general corporation tax liability should other states impose retaliatory taxes, although this would reduce the revenue raised under the option.

Opponents might argue that with one of the highest tax rates (combined city and state) in the country, plus other states' retaliatory taxes that might be triggered if the city reinstituted taxation of insurance companies, the additional burden could be enough to drive insurance firms with large offices and staffs in the city out of New York. Moreover, the incidence of the insurance corporation tax is unclear. To the extent that insurance companies can pass the additional tax on to their customers in the form of higher premiums, this tax would indirectly increase the tax burden of New York City residents, which is already high relative to the remainder of the country.

OPTION:

Repeal the Tax Exemption for Vacant Lots Owned by Nonprofits

Revenue: $10 million annually

Sections 420-a and 420-b of the New York State Real Property Tax Law provide for full property tax exemptions for religious, charitable, medical, educational, and cultural institutions. In fiscal year 2016, the city issued exemptions for 11,763 parcels owned by nonprofits with a total market value of $49.2 billion. Of these parcels, 55.6 percent were owned by religious organizations; 21.2 percent by charitable organizations; 9.4 percent by medical organizations; 9.6 percent by educational institutions; 2.6 percent were being considered for nonprofit use; and the remaining 1.7 percent were owned by benevolent, cultural, or historical organizations.

Included among the exemptions were around 776 vacant lots with a total market value of $632.9 million. The cost to the city for exempting the vacant lots was $11.2 million in 2016 and the median tax savings was $3,158 per parcel. Three-quarters of all vacant lots held by nonprofits were owned by charitable and religious organizations. Just under a third of the vacant lots were small, less than 2,500 square feet. The median tax expenditure (amount of taxes forgone) for small vacant lots was $1,034 and $4,537 for larger ones.

This option, which would require a change in state law, would repeal the exemption under Sections 420-a and 420-b for vacant land. Since small parcels may be unsuitable for development, the exemption would be retained for vacant lots less than 2,500 square feet. Ending the exemption for vacant lots 2,500 square feet or larger owned by organizations that qualify under the existing law would generate $10.0 million for the city.

Proponents might argue that since vacant land is undeveloped, it is not being actively used to support the organizations' mission, which is the rationale for providing the exemption. The tax would provide nonprofits with an incentive to develop their lots—expanding the services and benefits they bring to their communities. Additionally, because liability would increase with lot value, the incentive to develop would be larger for those properties with better alternative uses. By excluding small lots, the option would not penalize organizations for owning difficult-to-develop parcels. Lastly, to ensure eliminating the exemption is not deleterious to small nonprofits, lots owned by organizations with annual revenues below a threshold could remain exempt.

Opponents might argue that repealing the exemption would place additional financial strain on nonprofits that are already stretched to provide critical services in their communities. Organizations may be holding on to the land with the goal of developing or selling it later. Thus, eliminating the exemption could force many organizations to forgo the lots' future community or fiscal benefits. Additionally, opponents might argue that while the lots are underutilized from a development standpoint, they may nonetheless serve useful community purposes such as hosting playgrounds or gardens.

OPTION:

Revise the Coop/Condo Property Tax Abatement Program

Revenue: $117 million annually

Recognizing that most apartment owners had a higher property tax burden than owners of Class 1 (one-, two-, and three-family) homes, in 1997 the Mayor and City Council enacted a property tax abatement program billed as a first step towards the goal of equal tax treatment for all owner-occupied housing. But some apartment owners—particularly those residing east and west of Central Park and in northern Brooklyn—already had low property tax burdens. IBO has found that 45 percent of the abatement program's benefits are going to apartment owners whose tax burdens were already as low, or lower, than that of Class 1 homeowners.

The abatement has been renewed five times, most recently in June 2015 and extended through 2019. The prior extension, covering 2013 through 2015, included a provision to phase-out the abatement for nonprimary residences by 2015. The change did not alter the overall inefficiency of the abatement, with $196 million still being "wasted" in 2016.

Under the option outlined here, the city could reduce the inefficiency that remains in the abatement program even after the latest changes by restricting it either geographically or by value. For example, certain neighborhoods could be denied eligibility for the program, or buildings with high average assessed value per apartment could be prohibited from participating. Another option would be to exclude very high-valued apartments in particular neighborhoods from the program. State approval is necessary for any of these options.

The additional revenue would vary depending on precisely how the exclusion was defined. While it is unlikely that an exclusion like the ones discussed above could eliminate all of the inefficiency, it should be possible to reduce the waste by at least 60 percent.

Proponents might argue that such inefficiency in the tax system should never be tolerated, particularly at times when the city faces budget gaps. Furthermore, these unnecessary expenditures are concentrated in neighborhoods where the average household incomes are among the highest in the city. Since city resources are always limited, it is important to avoid giving benefits that are greater than were intended to some of the city's wealthiest residents.

Opponents might argue that even if the abatement were changed in the name of efficiency, the result would be to increase some apartment owners' property taxes at a time when the city faces pressure to reduce or at least constrain its very high overall tax burden. In addition, those who are benefiting did nothing wrong by participating in the program and should not be "punished" by having their taxes raised. The abatement was supposed to be a stopgap and had acknowledged flaws from the beginning. The city has had about 20 years to come up with reforms to the underlying assessment system, but so far has failed to do so. The change this year will reduce the dollar amount being wasted, but is not the comprehensive reform that the city committed to implement.

OPTION:

Tax Carried Interest Under the Unincorporated Business Tax

Revenue: $200 million annually

New York City's unincorporated business tax (UBT) distinguishes between ordinary business income, which is taxable, and income or gains from assets held for investment purposes, which are not taxable. Some have proposed reclassifying the portion of gains allocated to investment fund managers—also known as "carried interest"—as taxable business income.

New York City currently reaps a substantial amount of tax revenue from managing partners of investment funds—perhaps upward of $500 million a year, including both UBT and personal income tax (PIT) revenue from managing partner fees (which are based on the size of the assets under management rather than investment gains) and additional PIT from carried interest earned by city residents.

Were the city to reclassify all carried interest as ordinary business income (exempting only businesses with less than $10 million in assets under management), IBO estimates that annual UBT revenues would rise by approximately $217 million and PIT revenues fall by around $17 million (personal income taxes already being paid on carried interest would be reduced by the PIT credit for UBT taxes paid by residents), yielding a net revenue gain of about $200 million. This is an average of what we could expect to be a highly volatile flow of revenue. The reclassification of carried interest would require a change in state law.

Proponents might argue that because carried interest payments often far exceed the return on the managing partner's own (generally small) capital stake in the investment fund, the income in question is better characterized as a payment for services—which should be taxed as ordinary income—than as a return to ownership. Inducement to avoid the tax would be much smaller than under reclassification for federal income tax purposes. (The latter would raise the federal tax rate on carried interest from 20.0 percent to 39.6 percent for most managing partners. The city UBT rate is 4.0 percent, but personal income tax deductibility would lower the average impact closer to 2.2 percent.)

Opponents might argue that it is the riskiness of the income (meaning how directly it is tied to changes in asset value) that determines whether it is taxed as ordinary income or as capital gains, not whether the income is from capital or labor services. Thus we have income from capital (most dividends, interest, and rent) that is taxed as ordinary income, as well as income from labor services (for example, labor put into renovating a house) that is taxed as gains. By this criterion, most carried interest should continue to be taxed (or in the case of the UBT, exempted) as capital gains when it is a distribution from long-term investment fund gains. It may also be objected that New York City is already an outlier in its entity-level taxation of partnerships (neither the state nor the federal government do this), and any move to further enlarge the city business tax base ought to be offset by a reduction in the overall UBT rate. In this way, negative impacts on the scale of future investment company activity in the city might be mitigated by positive impacts on the scale of other business activities.

OPTION:

Tax the Variable Supplemental Funds

Revenue: $4 million annually

Variable Supplemental Funds (VSFs) originated in contract negotiations between the city and the uniformed police and fire unions. In 1968, management and labor jointly proposed legislation allowing the Police and Fire Pension Funds, whose investments were limited at the time to fixed-income instruments, to place some resources in riskier assets, such as common stock, with the expectation that investment earnings would increase. The city hoped that the higher returns could offset some of its pension fund obligations, and if returns were sufficient, some of the gains were to be shared with retired police and firefighters.

The VSFs—which no longer vary—are currently fixed at $12,000 per annum payable on or about December 15 of each year. This amount is reduced by any cost-of-living adjustment received in the same calendar year until age 62. Members of the Police and Fire Pension Funds are eligible for VSF payments if they retire after 20 or more years of service and are not going out on any type of disability retirement. The New York City Employees Retirement System (NYCERS) administers the VSFs for retired housing and transit police officers. Correction officers also have a VSF administered by NYCERS. Until recently, there were not sufficient funds to allow payment of the annual $12,000 VSF to otherwise eligible uniformed correction officer retirees; however, these retirees received their full VSF payment last year and will again receive it this year. Beginning in 2019, VSF payments to correction officers will be guaranteed regardless of fund performance.

Currently, VSF payments are exempt from state and local income taxes much as regular public pensions. Since the applicable provisions of the city's Administrative Code specifically states that VSF payments are not a pension, and the respective VSF funds are not considered pension funds, taxing these funds would not violate the state Constitution. Under this option, which would require state approval, VSF payments would be taxed and treated as any other earnings. Regular pension payments would not be affected by this option. Based on data through December 31, 2014, 29.4 percent, 25.8 percent, and 45.6 percent of the VSF recipients in the Police, Fire, and NYCERS (uniformed correction) Pension Funds, respectively, were city residents who thus would pay more local personal income tax under this option.

Proponents might argue that since the Administrative Code plainly states that these payments are not pension payments, it is inconsistent to give VSF payments the same tax treatment as municipal pensions. Additionally, since these payments are only offered to uniformed service workers who typically enter city service in their 20s and leave city service while still in their 40s, most of these employees work at other jobs once they retire from the city and thus, any taxation of these benefits would have only a small impact on the retirees' after-tax income. Finally, while some may argue that the estimated tax revenue is not that big now, it would grow as current employees retire and live longer, and as annual VSF payments for uniformed correction officers become guaranteed in 2019.

Opponents might argue that the taxation of these benefits could encourage retirees to move out of the city or state. Others may argue that since the uniformed unions allowed the city to invest in riskier, but higher yielding asset classes, that they should be able to enjoy a share of the resulting higher rates of returns without being subject to taxation, which would reduce the extent of gain sharing. They might also argue that for those retirees who do not get other jobs the tax could have a significant impact on their retiree income.