



INSIDE THE BUDGET

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Personal Income Tax Surcharge Reduced

After nearly a year of various proposals to eliminate or trim the city's personal income tax (PIT) surcharge, the Mayor and the City Council enacted legislation reducing the PIT surcharge in early December. While the surcharge cut will reduce PIT liability for all city taxpayers starting January 1, 2001, high-income taxpayers will receive a relatively smaller share of the tax savings, compared with their share of all PIT liability.

Background. Prior to this change, the PIT surcharge has equaled 14 percent of non-surcharge or "base" tax liability, which in turn is determined by the amount of taxable income and a schedule of income brackets and associated marginal tax rates. Instituted in 1991 as a temporary, three-year measure to boost city revenues, the surcharge has been renewed several times and under current law will expire at the end of calendar year 2001.

Earlier this year, when the city's budget for fiscal year 2001 was being developed and negotiated, several different proposals for reducing the PIT surcharge were considered. The Mayor initially proposed eliminating the surcharge and then, in the face of mounting budgetary pressures, called for halving it. In contrast, the City Council advocated ending the surcharge in conjunction with making the schedule of base PIT rates more progressive; taken together, these proposed changes would have concentrated the tax reductions among lower and middle-income filers.

The enacted surcharge cut. The tax cut ultimately enacted this month had been informally agreed to by the Mayor and the City Council last June when the city's fiscal year 2001 budget was adopted. Starting in January, the surcharge on income from all but the top bracket will be halved, while the surcharge on income in the top bracket will remain unchanged. (There are currently four income brackets.)

Despite keeping the surcharge at 14 percent of base liability for the portion of income in the top bracket, all city taxpayers will receive a personal income tax cut. This can be illustrated with an example. The top income bracket begins at \$50,001 of annual income for single filers. Thus, single filers with incomes of \$50,000 or less in 2001 will pay half of the surcharge that they would have paid in the absence of the recent cut. The tax cut increases as income rises, until it reaches a maximum of \$105 for single filers with incomes above \$50,000. Similarly, married couples filing joint returns will receive a maximum cut of \$189 for taxpayers with incomes above \$90,000, while heads of household (single parent) filers will receive a maximum cut of \$126 if their taxable incomes are greater than \$60,000.

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Budget Primer: What is New York City's Financial Plan?

The financial plan is a multi-year plan for how New York City expects to spend its budget to run the government and deliver city services. The financial plan is a blueprint for....

- how the city government spends money.
What activities are funded? How much does it spend for education, sanitation, public safety?
- how the city government pays for its activities.
How much revenue does it raise through different kinds of taxes, fees for services, or aid from the New York State and federal governments?
- balancing the city's budget.
The city runs surpluses when revenues are greater than spending. Conversely, gaps are projected when spending is expected to exceed revenues. The city can

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PIT Surcharge Reduction: Tax Savings By Income Groups, Tax Year 2001
 After Surcharge Reduction

| Income Group | Percent of Tax Returns | Tax Savings (\$ in millions) | Percent of Tax Savings | Tax Savings Per Return | Percent of Total PIT Liability | Tax Savings As Percent Of Pre-Cut Liability |
|-----------------------------|------------------------|------------------------------|------------------------|------------------------|--------------------------------|---|
| Under \$30,000 | 49.3% | \$16.6 | 10.2% | \$11 | 3.3% | 7.8% |
| \$30,000 to \$59,999 | 26.2% | \$50.1 | 30.8% | \$61 | 12.0% | 6.6% |
| \$60,000 to \$99,999 | 13.9% | \$47.6 | 29.2% | \$110 | 13.6% | 5.6% |
| \$100,000 to \$124,999 | 3.3% | \$14.4 | 8.9% | \$139 | 5.0% | 4.6% |
| \$125,000 to \$249,999 | 4.5% | \$20.4 | 12.5% | \$146 | 11.3% | 1.4% |
| \$250,000 to \$999,999 | 2.3% | \$11.1 | 6.8% | \$152 | 17.9% | 0.2% |
| <u>\$1,000,000 and over</u> | <u>0.5%</u> | <u>\$ 2.6</u> | <u>1.6%</u> | <u>\$159</u> | <u>36.8%</u> | 0.1% |
| Total | 100.0% | \$162.7 | 100.0% | | 100.0% | |

SOURCE: IBO.

Notes: Income is measured by federal adjusted gross income in 1999 constant dollars. For all filers, the average tax savings per return is \$52, equivalent to 2.7 percent of PIT liability before the surcharge cut.

Fiscal cost. Because the enacted surcharge reduction effectively caps the amount of the tax cut for upper-income filers, its cost to the city is considerably less than the cost of previous proposals that would have given high-income filers tax cuts in proportion to their PIT liability. IBO estimates that the new tax cut will reduce PIT revenues by \$81 million in fiscal year 2001, when the impact of the cut will be felt for only half the fiscal year. Assuming the surcharge is renewed, the tax cut will reduce PIT revenues by between \$172 million and \$201 million in each of the next three years. In contrast, last spring's Executive Budget proposal to simply halve the surcharge rate was estimated to have cost between \$345 and \$406 million annually. (IBO's estimates of the enacted tax cut are \$5 million to \$9 million a year lower than the Administration's.)

Distribution of the benefits. A smaller share of the total tax cuts generated by the reduced surcharge will be distributed to upper-income taxpayers, in comparison with previous proposals and with the distribution of PIT liability. IBO's estimates of the tax savings by income groups, based on an analysis of a newly available sample of 1998 tax returns, are reported in the table below.

We project that for the 2001 tax-paying year, 8.4 percent of the tax savings from the PIT surcharge cut will be received by the 2.8 percent of tax filers with adjusted gross incomes of \$250,000 or more (1999 dollars, adjusted for inflation). This small group of filers, however, is projected to account for almost 55 percent of PIT liability, reflecting

New York City's great concentration of wealth among upper-income households. In contrast, over 70 percent of the tax cuts resulting from reducing the surcharge will be received by filers with incomes below \$100,000—far greater than their 28.9 percent share of total PIT liability.

Because PIT cuts for top-bracket filers are capped, tax savings as a percent of PIT liability decreases sharply among these high-income taxpayers. As shown in the last column of the table, the total tax savings to be received by the groups of filers with incomes below \$100,000 ranges from 5.6 percent to 7.8 percent of their pre-tax cut PIT liabilities. In contrast, for the groups of filers with incomes of \$250,000 or more the comparable shares are 0.2 percent or less.

Conclusion. The recently enacted surcharge reduction has been structured to guarantee tax savings to all taxpayers yet to provide a relatively smaller share of the benefits to upper-income filers. As documented in IBO's June 2000 report, "Big City, Big Bucks: NYC's Changing Income Distribution," the share of city income being received by this group of filers has increased greatly in recent years, and the latest available information confirms these trends. An update of the data presented in "Big City, Big Bucks" is available upon request.

For more information, contact Michael Jacobs, Senior Economist, at (212) 442-0597 or MichaelJ@ibo.nyc.ny.us.

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raise revenues or cut spending to balance its budget. Sometimes, however, the city has used a surplus in one year to close a gap in a future year.

The Mayor releases a financial plan four times each fiscal year (the city's fiscal year runs from July 1st to June 30th). These four plans are commonly referred to as the *Adopted Plan* (June), *November Plan*, *January Plan*, and *Executive Plan* (April).

The first financial plan of each fiscal year reflects the city's anticipated revenue and spending based on the *Adopted Budget*. Subsequent plans build on the previous financial plan and reflect adjustments in anticipated spending and revenues that occur during the fiscal year.

The Financial Plan for 2001-2004

The city has released two financial plans this fiscal year: the *Adopted Plan* and the *November Plan*. Summary tables and highlights of both financial plans—including planned spending, revenue, and prospective budget gaps or surpluses—are available on IBO's website (<http://www.ibo.nyc.ny.us>) or on request. Summaries of the city's *January Plan* and *Executive Plan* updates will be added to IBO's website as they are released.

The main changes included in the city's *November Plan* are summarized below. The *November Plan*, updating the *Adopted Plan*, reports that ...

- The city's financial outlook for 2001 continues to be strong, with a \$1.3 billion surplus anticipated for this fiscal year (ending June 30, 2001)—an increase of \$347 million over what was initially projected in the *Adopted Plan*.

- The budget gap (difference between revenues and expenditures) for 2002 continues to be significant (\$2.5 billion), but is a \$172 million decrease from what was initially projected in the *Adopted Plan*. The projected gaps for 2003 and 2004 (\$3.0 billion each year) have increased by \$312 million and \$360 million, respectively, since adoption.

• Revenues

- Projected 2001 tax revenues have increased by \$420 million since the budget was adopted—largely due to

increased revenues in the personal income tax (\$175 million), general corporation tax (\$110 million), and sales tax (\$92 million). The plan also anticipates smaller increases in tax revenues for 2002 through 2004.

- The city trimmed back the package of tax cuts proposed in June. Among other changes, a smaller than originally proposed reduction in the city's personal income tax surcharge will take effect in January 2001. (See the accompanying article.) As a result, the *November Plan* reports that the city will retain \$315 million in tax revenues that the *Adopted Plan* anticipated would have been lost to tax cuts. Slightly smaller adjustments (under \$300 million) are also reflected in each year 2002 through 2004. In addition, the tax program calls for gradual elimination of the commercial rent tax, extension of the coop-condo abatement, and a package of economic development incentives for the boroughs outside of Manhattan and north of 96th Street.

• Expenditures

- Pension costs increased by \$132 million in 2001, rising to \$468 million by 2004, as a result of state legislation providing new automatic cost of living adjustments for most retired city employees.

- Overtime needs identified within the Police Department resulted in a spending increase of \$115 million for 2001.

- As a result of rising fuel costs nationwide, the *November Plan* includes an additional \$49 million for these expenses in 2001 and for each year in the plan period.

- The city anticipates that inpatient hospital and pharmaceutical Medicaid expenses will be higher than initially projected and have increased Medicaid expenditures by \$65 million in 2001, growing to \$102 million by 2004.

- Federal aid anticipated in the *Adopted Plan* for Medicaid expenses will not be realized as planned, resulting in an increase in city expenditures of \$75 million in 2001 and each year through the plan period.

For further information about this issue, contact Frank Posillico, IBO Deputy Director, at (212) 442-0222 or by email at FrankP@ibo.nyc.ny.us.