City of New York
Independent Budget Office

INSIDE THE BUDGET

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Special Report: 2002 Budget Tax Cuts

Tax Changes Still Need State or City Action

Although a number of the tax cuts proposed by the Mayor and the City Council this spring are included in the city's recent budget agreement, not all of them are expected to be implemented in their current form. What follows is a review of the tax cuts in the Adopted Budget and their current legal status. (For more detail on the proposals, see IBO's *Considering Tax Cuts*, May 2001.)

Four proposals—a further cut to the personal income tax (PIT) surcharge, extension of the coop/condo tax abatement, a commercial rent tax cut, and extension of the Lower Manhattan Revitalization Program—are already incorporated in the Adopted Budget's projections of tax revenues. In budget jargon the cuts have been "baselined," even though each requires some further state and/or city legislation before they can be fully implemented. IBO's estimate of the total cost of the four is $401 million in 2002, growing to $497 million by 2005—slightly higher than projections in the city's four-year financial plan.

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Real Estate Cut Not Disclosed

The fiscal year 2002 budget and accompanying financial plan adopted last month excludes the cost of a significant tax change that will defer payment of property tax bills on some new commercial buildings for up to two additional years. IBO estimates the change could have an annual cost to the city of up to $20 million by 2005. Regardless of the merits of this new tax reduction, its exclusion represents a serious lapse in the city's policy of disclosing and documenting the costs of its changes in tax policy.

The change eliminates tax assessments for three years—up from one year currently—on new buildings under construction. Known as progress assessments, the change was not on any of the initial lists of tax options proposed by the Council or the Mayor during this year's budget process. Nor was it listed among the items in the Adopted Budget tax program, despite being approved by the City Council's Finance Committee with the Administration's endorsement as budget negotiations were being completed. The change—and its cost—is also missing from the technical documentation prepared by the Mayor's Office of Management and Budget. This documentation is where the city normally accounts for the revenue effects of tax changes.

Background

Property taxes are based on the value of the land and improvements—generally buildings. At a minimum, the value of a building on a property includes the cost of the materials (steel, bricks, concrete) used to construct it. With progress assessments, which the city first authorized in 1913, the tax on the value of the partially constructed building is waived for one year; the tax on the value of the land remains. Until now, the waiver covered one year's assessment. After the progress assessment period, if the building is still under construction it is assessed on the value of the improvements already put in place. Once a commercial building is ready for occupancy, its value is determined by the current and anticipated income the building can generate from tenants.

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Cut Not Disclosed

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Building projects—particularly large commercial developments—have grown more complex and often take more than one year to complete. With the progress assessment limited to one year, the developer of a multi-year project begins to face tax bills in subsequent years, even if the building is not yet generating income to pay them. Typically, provision for these taxes adds to the amount borrowed by the developer to finance the project. A proposal to extend the progress assessment period to help lower the cost of commercial development was among the recommendations of Senator Charles Schumer's task force (the Group of 35). The Real Estate Board of New York has also advocated extending the progress assessment period.

Extending Progress Assessment

As enacted, the progress assessment period has been extended to a maximum of three years for commercial properties. Residential buildings and hotels are excluded, as is the new AOL/Time Warner development at Columbus Circle. Because many commercial projects outside of midtown Manhattan already receive full tax exemptions under the Industrial and Commercial Incentive Program, most of the new benefits are expected to be focused in Manhattan's central business district.

Buildings begun after January 5, 2000 will receive the benefit. Because the taxable status of a property for a particular fiscal year is determined on the January 5 preceding the start of the fiscal year, the actual time with no assessment can vary depending on when construction begins. The earliest that buildings can begin to receive a second progress assessment is for fiscal year 2003, and 2004 is the first year that the full impact on city revenues will be felt.

The fiscal impact of this change will depend greatly on the pace and location of commercial development over the next few years. Based on an analysis of recent construction trends and projections for planned development activity across the city, IBO projects that the change could reduce property tax revenues by as much as $13 million in 2003 and $20 million in 2005. Although the city's budget documents do not acknowledge the policy change, a City Council Fiscal Impact Statement introduced at a Finance Committee hearing last month estimated the costs at $6.5 million in 2003, growing to $9.8 million in 2005.

Budget Process

The city has set a high standard for disclosing the costs of tax changes and proposals in the past. Regardless of the merits and cost of this particular or any other proposal, all significant tax policy changes—such as this one—should be accounted for and documented. Such openness makes it possible for New Yorkers to understand the city's budget and see how tax benefits are distributed.

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Tax Cuts Need Action

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Cost of Tax Cuts, Adopted Budget for 2002 and Financial Plan
Dollars in millions

	Fiscal Years			
	2002	**2003**	**2004**	**2005**
Budgeted Tax Cuts				
New PIT Surcharge Cut	$179	$188	$200	$212
Extend Coop/Condo Abatement	190	203	215	227
CRT Threshold Increase	25	26	27	28
Extend Lower Manhattan Program	8	19	31	30
Provision for Omnibus Bill	100	200	200	200
Total Budgeted Tax Cuts	**$501**	**$636**	**$673**	**$697**
Omnibus Bill Items				
Sales Tax Elimination on Clothing	$31	$109	$113	$116
Deepening Coop/Condo Abatemen	42	45	48	52
Hotel Tax Cut	21	42	43	44
Mortgage Recording Tax Cut	12	24	25	25
Dependent Care Credit, PIT	20	20	20	20
Earned Income Tax Credit, PIT	13	14	14	17
"Green" Building Abatement	--	1	2	2
Total Omnibus Bill Items	**$139**	**$255**	**$265**	**$276**

Source: IBO.

The remaining proposals, each requiring state legislative approval, have been combined into a single piece of legislation—the Omnibus bill—that is awaiting action in Albany. None of these cuts are currently reflected in the Adopted Budget and the current financial plan's revenue forecasts for the effected taxes. Instead the financial plan provides a lump sum for each year—$100 million in 2002 and $200 million in 2003 and beyond—to reflect the cost of the combined package. Because these sums are less than the total cost of the items in the Omnibus bill, it is not clear which items the city would actually implement if the bill is enacted.

Baselined Cuts

Among the four baselined tax cuts, three are unchanged from earlier Mayoral and City Council proposals. The cut to the PIT surcharge did not need state legislative approval, but the surcharge itself is set to expire at the end of this calendar year. A bill introduced in Albany would both renew the surcharge for another two years as well as set the new rates as the highest permissible under state law. Likewise, legislation has been introduced in Albany to extend the existing coop/condo abatement through 2005. The current abatement expired at the end of the 2001 fiscal year. A bill granting the necessary state authorization to continue the Lower Manhattan Revitalization Program, which expired last March, also has been introduced in Albany. The budget would extend the program essentially in its current form through March 2004. The only change would be to exclude new leases in the World Trade Center from commercial rent tax and utility tax benefits (the trade center is exempt from property taxation).

The baselined cut to the commercial rent tax (CRT) differs significantly from earlier proposals—it is smaller and less costly than what either the Mayor or the Council had been proposing. Under current law, only commercial tenants in Manhattan south of 96th Street with annual base rents greater than $150,000 are subject to the tax. The tax cut would increase this liability threshold to $250,000 in annual rent, thus reducing the number of businesses subject to the tax, but would not change the tax rate. While state legislative approval to cut the CRT is not necessary, the Council has not yet enacted the new liability threshold into city law.

The Omnibus Bill

The Omnibus bill would authorize the city to enact all of the remaining tax cuts. As currently packaged, all the items in the bill would cost a total of $139 million in

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Correction

Regarding "City Changes Plans for Settlement Revenues" (Inside the Budget no. 85, June 19), the City Comptroller's office wishes to note that the basis for their decision to disallow the use of capital funds for certain costs of closing the Fresh Kills landfill was that no capital asset would be created.

Tax Cuts Need Action

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2002, $255 million in 2003, and $276 million by 2005, well above the lump sum included in the Adopted Budget and financial plan. Most of the provisions of the Omnibus bill would give the city latitude in structuring and timing the specific cuts, with the expectation that city action would be contingent upon the city's fiscal condition. Even if Albany gives the city the authority to implement these changes by approving the Omnibus bill, the city may ultimately choose to not enact all of them.

The most costly item in the Omnibus bill is the proposal to eliminate the 4 percent sales tax on clothing and footwear items priced at $110 or more, starting March 1, 2002. It may not be easy for the city to secure the support of state lawmakers for additional sales tax cuts in the city, given that several localities elsewhere in New York State opted not to drop their local sales taxes on under-$110 clothing items.

Most of the remaining provisions in the bill are essentially unchanged from the proposals made earlier this spring by either the Mayor or the Council. These include proposals to: provide coop and condo apartment owners a deeper abatement; eliminate the $2 per night flat fee charged for hotel rooms renting for $40 or more; cut the mortgage recording tax for first time homebuyers with mortgages less than $300,000; create a refundable credit against city PIT liability for a portion of qualified child and dependent care expenses; and create a refundable Earned Income Tax Credit (EITC) against the city PIT. This last proposal, which would use surplus Temporary Assistance for Needy Families (TANF) funds to pay for EITC refunds (permissible under federal guidelines), may also make passage of the Omnibus bill problematic. It is far from certain that state lawmakers would be willing to share the state's TANF surplus to pay for a city EITC. Without the use of TANF to finance EITC refunds, the cost to the city would be substantially higher, ranging from $56 million to $58 million per year during the financial plan period.

Finally, the Omnibus bill includes one proposal that was not part of the Mayor's or the Council's earlier tax packages. It would create a city real property tax abatement for newly constructed or rehabilitated small commercial and residential buildings that meet certain environmental and energy efficiency standards. This "green" building abatement would equal 1 percent of eligible costs for a period of five years, with costs capped at $5 per square foot. If enacted into law as proposed, the abatement would cost the city $1 million in 2003 and $2 million a year thereafter.

For further information contact Michael Jacobs, senior economist, at (212) 442-0597 or by e-mail at michaelj@ibo.nyc.ny.us.

IBO Welcomes New Staff Member

Molly Wasow joined IBO in June 2001 as a budget and policy analyst focused on housing issues. Prior to IBO, Ms. Wasow worked for a nonprofit trade association, where she conductted research into charitable giving practices in the US, and designed and implemented association programs. Ms. Wasow has a Master's in Public Policy from the Goldman School at UC Berkeley, with an emphasis on affordable housing and homelessness policy. She received her B.A. from Amherst College.

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