

What the Income Tax Changes Mean to New York City Filers

Overview. As a result of the three-year increase in New York City's personal income tax (PIT) for upper income taxpayers, an estimated 135,000 city residents will owe an additional \$514 million of PIT in calendar year 2003. In the following two years the number of New Yorkers paying more will increase slightly as will the total taxes owed—\$539 million more for calendar year 2004 and \$563 million for 2005. Affected taxpayers will also be paying more in state income taxes, which were also raised for 2003 to 2005 as part of the Legislature's enacted budget. Both the city and state tax increases are retroactive to January 1, 2003.

Two changes to New York City's PIT affecting calendar years 2003, 2004, and 2005 will add to many upper income New Yorkers' tax burdens and yield additional city revenues for fiscal years 2004, 2005, and 2006: the creation of two new brackets of taxable income with higher marginal rates, and "recapture" provisions that increase the tax rate paid on *all* income for most filers subject to the new, higher marginal rates.

Two New High-Income Brackets and Rates. Prior to the PIT hike, the top bracket started at \$50,000 of taxable income for single filers, \$60,000 for heads of households (single parents), and \$90,000 for married couples filing jointly; filers paid at a rate of 3.648 percent on all income in the top bracket. The new increase does not affect the rates and income definitions of the existing brackets, but adds a fifth bracket, starting at \$100,000 for single filers, \$125,000 for heads of households, and \$150,000 for joint filers, and a sixth, top bracket starting at \$500,000 for all filers. The income definitions of the new fifth and sixth (top) tax brackets of the city PIT are identical to those of the two new brackets being added to the state PIT. The marginal city tax rate for the top bracket is 4.45 percent for all three years, while the rate in the fifth bracket starts at 4.25 percent in 2003 but declines to 4.175 percent in 2004 and 4.05 percent in 2005. IBO estimates that the number of city resident filers whose city PIT burden will increase as a result of the new brackets and higher top rates will grow from 135,000 in 2003 to 167,000 in 2005.

Recapture Provisions. In addition to new brackets and rates, recapture provisions have been incorporated into the structure of the city PIT, similar to the recapture that has been part of the state tax for many years. These provisions add to the tax increase of filers with adjusted gross incomes over \$150,000 by taxing some or all taxable income at the filer's highest marginal rate, including the income in lower brackets. (Adjusted gross income minus deductions and exemptions equals taxable income.)

For example, the city PIT liability of filers whose taxable incomes exceed \$500,000 and thus reach the highest bracket will equal 4.45 percent (the highest marginal rate) of *all* taxable income, not just of the income in the highest bracket. For filers whose taxable income falls within the new fifth bracket, some or all of the income in the first four brackets may be taxed at the fifth bracket rate (4.25 percent in 2003), depending on the extent to which the taxpayer's adjusted gross income (AGI) exceeds \$150,000. None of the taxable income in the first four brackets would be taxed at the fifth-bracket rate if the taxpayer's AGI is below \$150,000, while all would be taxed at the higher rate if AGI

exceeds \$200,000. For taxpayers with AGI between \$150,000 and \$200,000, the percentage of income beneath the fifth bracket that is taxed at the new, higher rate gradually rises, from 0 percent to 100 percent. These recapture provisions account for 22 percent of all the additional revenue expected from the city's enacted PIT increase.

The recapture provisions create sharp breaks or jumps in tax liability as income rises. For example, with the recapture provision in effect, a joint filer with \$500,001 in taxable income would owe \$22,250 in 2003. The single dollar above \$500,000 results in a \$1,000 jump in tax liability. By comparison, using the new rates without the recapture provision, that additional dollar of income would add \$0.045 to the \$20,135 owed on \$500,000. Jumps as sharp as those produced by the recapture provisions are undesirable because the tax consequences of economic decisions take on greater significance and possibly alter behavior in undesirable ways.

Withholding Change. The legislation enabling the city PIT increase also authorizes more income to be withheld from the pay of employees whose incomes are high enough to make them likely to owe more tax. For the latter half of this year, additional funds will be withheld to reflect the fact that the tax increase is retroactive to January 1, 2003.¹

Distributional Impact. No city residents with taxable incomes below \$100,000—the vast majority of all filers—will be subject to either a city or state tax increase, while almost all of the 61,939 filers with incomes above \$250,000 will be paying more this year. Just over 135,000 city taxpayers (4.1 percent of all filers) will owe an additional \$514 million of city PIT as a result of the new increase, with those earning over \$1 million bearing 61.5 percent of the tax increase. The average tax hike for all those who will be paying more will be \$3,808; for millionaires, it will be \$29,273. Those paying higher city taxes will also incur greater state PIT liability. Because both the total number of city filers with a state PIT increase and the aggregate amount of money that the state will receive from that increase are fairly close to the comparable city numbers, the average state tax increase of \$3,703 is very similar to the city increase. As a result, on average affected taxpayers will be paying roughly \$7,500 more in combined state and local income taxes in the current year.

A single filer with a taxable income of \$125,000 will owe an additional \$151 in city PIT (a 3.4 percent increase) and \$163 in state tax (1.9 percent increase). A joint filer with the same income, however, will not be subject to any city or state tax increase. At a taxable income of \$205,000, the city PIT increase would vary, from \$1,353 for single filers (a 18.4 percent increase) to \$1,375 (18.8 percent increase) for heads of household to \$1,446 (19.9 percent) for joint filers, while the state PIT increase would be the same—\$1,333 (9.5 percent)—for all filers. Finally, all filers with taxable income equal to \$530,000 will pay \$4,505 (12.4 percent) more in state PIT while the city tax increases will equal \$4,369 (22.7 percent) for singles, \$4,392 (22.9 percent) for heads of household, and \$4,463 (23.3 percent) for joint filers.

**New York City and State Combined Personal Income Tax Increases for City Residents
Tax Year 2003**

Income Group	Total Number of City Filers	Number of Filers with City PIT Increase	Aggregate NYC PIT Increase (\$ in millions)	Average NYC PIT Increase
Under \$50,001	2,519,277	-	\$ -	\$ -
\$50,001 to \$100,000	513,024	-	\$ -	\$ -
\$100,000 to \$125,000	81,514	15,501	\$ 0.795	\$ 51
\$125,001 to \$250,000	106,963	62,574	\$ 53.091	\$ 848
\$250,000 to \$500,000	35,770	32,718	\$ 69.440	\$ 2,122
\$500,000 to \$1,000,000	14,639	13,431	\$ 74.735	\$ 5,564
Over \$1,000,000	11,530	10,801	\$ 316.163	\$ 29,273
All Filers	3,282,717	135,024	\$ 514.219	\$ 3,808

Income Group	Total Number of City Filers	Number of Filers with State PIT Increase	Aggregate NYS PIT Increase (\$ in millions)	Average NYS PIT Increase
Under \$50,001	2,519,277	-	\$ -	\$ -
\$50,001 to \$100,000	513,024	-	\$ -	\$ -
\$100,000 to \$125,000	81,514	17,522	\$ 0.934	\$ 53
\$125,001 to \$250,000	106,963	68,185	\$ 53.765	\$ 789
\$250,000 to \$500,000	35,770	35,595	\$ 72.694	\$ 2,042
\$500,000 to \$1,000,000	14,639	14,615	\$ 80.803	\$ 5,529
Over \$1,000,000	11,530	11,516	\$ 340.050	\$ 29,528
All Filers	3,282,717	148,064	\$ 548.247	\$ 3,703

SOURCE: IBO, based on 2000 PIT Sample File, Office of Tax Policy Analysis, Finance
NYS Department of Taxation and Finance.

NOTES: Income groups defined in terms of real (\$ 2000) New York adjusted gross income.
Average tax increases refer only to those paying higher taxes, not to all filers.

Estimates made by IBO and others of the PIT revenue to be generated by the tax increase do not take into account how the increases might influence the behavior of city residents and thus diminish the revenue boost. In the short run it is unlikely that many of the most affluent New Yorkers will move outside of the city in the face of a temporary tax increase. A more probable short-run effect is for some married couples who face a state and city PIT increase as joint filers to decide to file separately in order to avoid or minimize paying more, particularly since recent changes in the federal income tax have reduced the cost to many couples of filing separate tax returns.² City resident couples in the \$150,000 to \$250,000 income range might have considerable state and local tax incentives to file separately if both the wife and husband each have substantial earnings. For example, a couple whose taxable income is \$215,000 would pay \$1,506 in additional city PIT for calendar year 2003 if they file a joint return. Under the assumption that one spouse of this couple earns \$80,000 and the other earns \$125,000, if separate tax returns are filed only the latter would be subject to a \$211 city tax increase—a savings of \$1,295. If this couple's total income was divided less evenly, filing separately would not reduce the tax increase by as much. For example, if one spouse earns \$200,000, filing separately would only result in savings of \$183.

Written by Michael Jacobs

END NOTES

¹ In addition to authorizing the change in withholding tables, the PIT legislation also makes it more difficult for taxpayers to avoid penalties for underpayment of tax.

² Federal tax incentives would, of course, be an important factor for any couple deciding whether to file jointly or separately, and such incentives might outweigh any state and local incentives. In nearly all cases, New Yorkers must use the same filing status on their state and city tax returns as they use on their federal returns.

Typical PIT Increases, May 2003										
Tax Year 2003										
	<u>AGI</u>	<u>Taxable</u>	<u>Old</u>	<u>New</u>	<u>Change</u>	<u>% Change</u>	<u>Old</u>	<u>New</u>	<u>Change</u>	<u>% Change</u>
		<u>Income</u>	<u>NYC PIT</u>	<u>NYC PIT</u>	<u>NYC PIT</u>	<u>NYC PIT</u>	<u>NYC PIT</u>	<u>NYC PIT</u>	<u>NYC PIT</u>	<u>NYC PIT</u>
Single Filers										
	\$ 140,000	\$ 125,000	\$ 4,441	\$ 4,593	\$ 151	3.40%	\$ 8,483	\$ 8,646	\$ 163	1.92%
	\$ 175,000	\$ 155,000	\$ 5,536	\$ 6,228	\$ 692	12.49%	\$ 10,618	\$ 11,102	\$ 484	4.56%
	\$ 230,000	\$ 205,000	\$ 7,360	\$ 8,713	\$ 1,353	18.38%	\$ 14,043	\$ 15,375	\$ 1,333	9.49%
	\$ 550,000	\$ 530,000	\$ 19,216	\$ 23,585	\$ 4,369	22.74%	\$ 36,305	\$ 40,810	\$ 4,505	12.41%
Head of Household Filers										
	\$ 145,000	\$ 130,000	\$ 4,601	\$ 4,632	\$ 30	0.66%	\$ 8,849	\$ 8,881	\$ 32	0.36%
	\$ 180,000	\$ 155,000	\$ 5,513	\$ 6,230	\$ 717	13.00%	\$ 10,618	\$ 11,075	\$ 457	4.31%
	\$ 230,000	\$ 205,000	\$ 7,337	\$ 8,713	\$ 1,375	18.75%	\$ 14,043	\$ 15,375	\$ 1,333	9.49%
	\$ 550,000	\$ 530,000	\$ 19,193	\$ 23,585	\$ 4,392	22.88%	\$ 36,305	\$ 40,810	\$ 4,505	12.41%
Joint Filers										
	\$ 140,000	\$ 125,000	\$ 4,348	\$ 4,348	\$ -	0.00%	\$ 8,404	\$ 8,404	\$ -	0.00%
	\$ 185,000	\$ 155,000	\$ 5,442	\$ 6,253	\$ 811	14.90%	\$ 10,618	\$ 11,094	\$ 477	4.49%
	\$ 230,000	\$ 205,000	\$ 7,266	\$ 8,713	\$ 1,446	19.90%	\$ 14,043	\$ 15,375	\$ 1,333	9.49%
	\$ 550,000	\$ 530,000	\$ 19,122	\$ 23,585	\$ 4,463	23.34%	\$ 36,305	\$ 40,810	\$ 4,505	12.41%

SOURCE: IBO.