



Testimony to

**Joint Legislative Budget Hearing on
Executive Budget Revenue Proposals**

*Impact of Revenue Proposals on Business Competitiveness
and New York State's Economic Climate*

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February 3, 2009

This year's budget will affect New York's economy, its businesses, and its residents for years to come.

We already know that New York has been losing its competitiveness to other states, and to foreign competition.

Our job growth has lagged behind national trends for the past two decades (New York grew at about half the national rate during the 1990's, about 60 percent of the national rate in the 2000's); New Yorkers, especially the young and well educated, continue to leave for better job opportunities in other states; New York's high cost-of-doing business –taxes, especially RPT; energy costs, health care costs and others – discourage new investments by existing business, and smother entrepreneurs and the creation of new businesses and new jobs in emerging technology sectors.

Because of our weak competitive position, New York has lagged significantly behind national trends in recovering from the last two recessions.

We need to become more competitive, not less, in order to fully participate in the next national economic recovery.

Unfortunately, we see the Executive Budget proposal as a missed opportunity, taking us in the opposite direction.

In the face of falling consumer spending and falling business revenues, it imposes more than \$4 billion in new taxes, fees and assessments on the state's economy.

At a time when many businesses are struggling to earn a profit, and in some cases resorting to layoffs in response to the national economic downturn, we are imposing new business taxes, stripping away tax incentives from companies, and dramatically downsizing our economic development agencies and programs.

On both the spending and revenue side, this budget proposal is out of step with our economic capabilities and economic needs.

Our testimony this morning will highlight those revenue proposes included in the Executive Budget that are of greatest concern to our members, and in our view, that will hurt the state's economic competitiveness.

1. Role of Potential Fed Stimulus – Many are looking to the federal government to bail us out of our current and future budget messes.

While federal assistance is welcome, it has to be used in the right way.

To quote Governor Paterson, "We have got to learn that our spending cannot exceed our revenues. Even with the addition of resources from the federal government, what we are going to have to do is change the culture of spending in the state."

We applaud Governor Paterson's argument that, should New York receive a significant cash infusion from the federal government for Fiscal 2010, the state

should use those revenues to cut back on significant proposed tax and fee hikes, rather than restore or increase governmental spending.

2. Fiscal Reform Priorities - The Business Council's Board of Directors has identified a series of fundamental reforms that we believe would result in significant improvements in the state's financial condition, and ultimately in the competitiveness of its economic climate.

Among those are adoption of a real property tax cap, as advocated by Governor Paterson, coupled with significant mandate reform and local government consolidations, actions to reduce the enormous size and cost of local government, and the state's crippling real property tax burden.

Real property taxes are the most uncompetitive aspect of the state's tax burden, and while not a perfect remedy, we see real property tax caps as an effective means to control the costs imposed by property taxes, and coupled with mandate relief and consolidations, the only likely source of broad-based real property tax relief for the commercial and industrial sectors.

3. NYS Business Tax Climate – The Executive Budget "Economic and Revenue Outlook" argues that New York is an "average" state with regard to tax burden, looking only at state tax levies. It recognizes – however – a significant disparity in New York with regard to local taxes, especially real property and sales taxes.

We agree with their assessment that New York's total state and local tax burden is significantly above the national average. We disagree with the notion of New York being a moderate tax state, because that assessment ignores the full range of state-imposed costs on business, such as more than half a billion dollars per year in energy-related assessments – for example, the system benefit charge, renewable portfolio charge, and cost of CO₂ emission allowances.

Likewise, only \$1.7 billion of the more than \$4 billion in new revenue measures proposed in the Executive Budget are listed as "taxes," while major new business costs, including nearly \$1 billion in health care and insurance assessments, \$650 million in utility "assessments," would be left out of the Division of Budget's tax burden analysis, but would be very real to the businesses that would be adversely affected by these proposals.

Other national assessments of business tax climates illustrate our point.

The Council on State Taxation's annual assessment of state business tax burdens shows that New York's state and local tax burden as a share of gross state product to be 9th highest in the nation, and nearly 30 percent above the national average.

The Tax Foundation's "2009 State Business Tax Climate Index" ranks New York 49th, behind only New Jersey. This index is done with an emphasis on business competitiveness. It ranks (on a weighted basis), personal income taxes (30%), sales/excise taxes (22%), corporate taxes (20%), property (real & personal property, property transfer, and other) taxes (15%), and unemployment insurance taxes (12%). It includes major local-imposed taxes as well, such as local sales taxes and local real property taxes. Overall, it considers 112

variables, and is one of the most detailed, comprehensive assessments of the impact of state and local tax policy on a state's business climate.

In summary, even with moderately competitive personal and corporate income taxes, New York State is not competitive when comparing the broad range of taxes and assessments imposed on the private sector.

4. Revenue Proposals – The Executive Budget contains more than \$4 billion in new revenues through new, increased and expanded taxes, fees and other assessments, including more than \$3 billion in permanent revenue increases. Generally speaking, we question the imposition of significant, permanent revenue raisers during a period of economic recession, when the economy can least afford it, and when economic recovery is expected to restore some of our current revenue shortfalls.

The Executive Budget states that it includes \$640 million in new or increased direct taxes on business. As discussed below, this figure dramatically underestimates the impact of the proposed revenue package on the private sector employers and the state's economic climate.

The following provides a summary of what we see as the most damaging of the Governor's revenue proposals.

Health Care Taxes/Assessments - The rising cost of health care is our members' most significant cost of doing business concern. Yet when we look at the Executive Budget, we see that he has included over \$800 million in new taxes and assessments on health care and health insurance, including \$590 million within the Deficit Reduction Plan for the current fiscal year.

These increased insurance and health-related assessments and surcharges (we call them TAXES) will ultimately be passed through to businesses and consumers in the form of higher health and other insurance premiums.

The Business Council opposes these taxes. At a time when health care costs continue to skyrocket, employers, especially small business, will be hit hard by increased taxes on health insurance and health care services. These taxes hit the people who pay the premiums, in most cases employers and their employees. Health care and health insurance costs in New York are already sky-high.

New Yorkers - both individuals and businesses – that purchase health insurance currently pay more than \$3.1 billion in health taxes. It is estimated that the current health tax burden already adds between 3 and 7 percent to the cost of health coverage.

The Deficit Reduction Plan and Executive Budget would impose:

- \$226 million increase in the Insurance Department Section 332 assessments to pay for public health programs, Timothy's law mandate, tobacco prevention, early intervention program (60 percent of the overall \$382 million to be generated from the assessments imposed by the Insurance Department on all domestic insurers comes from health

insurers). This represents a huge shift of program costs from the General Fund and HCRA to the Department of Insurance assessments.

- \$240 million increase in the Covered Lives Assessment, raising this assessment to \$1.19 billion.
- \$62 million increase by raising the Article 32 premium tax on insurance companies from 1.75 percent to 2 percent.
- \$126 million by increasing the HCRA hospital services surcharge from 8.95 percent to 9.63 percent
- \$50 million from expanding the 9.63 percent hospital services surcharge to other services provided in other health-care settings
- \$63 million from establishing a health claims processing tax on third party administrators.

If approved, the health taxes in the Deficit Reduction Plan and Executive Budget will drive up the cost of health insurance for all Business Council member employers that purchase health coverage – from sole proprietors and small businesses to the largest self-insured companies – yet will provide no additional covered benefits or have any effect on addressing the rising cost of health care.

Rather, by pushing premiums higher, these taxes will force more business owners – particularly small business owners - to reduce or eliminate coverage for their workers or shift more of the cost to their employees, or will drive up the ranks of the state's uninsured.

For these reasons, The Business Council strongly urges you to reject these new and increased taxes.

Energy/Utility Assessments – With industrial and commercial electric power costs about 40 percent above national averages, energy costs are the second most significant cost-competitiveness factor cited by our members. In part, New York's high energy costs are driven by a growing array of state-imposed assessments – the System Benefit Charge, the Renewable Portfolio charge, and new costs related to the purchase of CO2 emission allowances – which together add nearly 10 percent to the cost of electric power.

The Executive Budget is proposing a massive \$600 million increase in the state's "Section 18-A" assessments on utilities (increasing the assessment rate from .3 percent of revenues to 2 percent), a significant share of which will hit electric and gas utilities, with a direct pass through to their business customers.

This proposal also affects telecommunication providers like Verizon and AT&T. As a result, the proposal further exacerbates the already unlevel playing field between utility and non-utility providers who now compete for telephone, broadband and video customers. This disparity alone puts Verizon at a \$52 million competitive disadvantage. In such a diverse and competitive marketplace,

it makes little sense to force one provider in the market to pay to do business in New York, while new providers are not subjected to these tax proposals. In addition, this proposal conflicts with the stated goals of many lawmakers who have expressed interest in seeing greater investment in broadband by private industry.

New York's already high energy costs are having an adverse impact on energy-dependent business sectors. Recent initiatives, such as the Regional Greenhouse Gas Initiative, could add \$250 million or more to annual energy costs. The Business Council opposes this significant new utility assessment.

The Executive Budget would also expand a bad policy initiative adopted in last year's budget, by subjecting electric generators to a \$10 million cap on tax liability under the Article 9-A corporate franchise tax, if the company pays its tax on basis of its in-state capital. This proposal hit the financial sector hard last, when the capital base cap was increased from \$1 million to \$10 million for non-manufactures and non-energy utilities. This proposal will subject generators to a projected \$17 million increase in corporate franchise taxes in a tax year when they have little or no operating profits. We opposed this increased capital base cap last year, and we continue to do so.

Insurance Assessments – Several of the proposals we mention above in context of health care insurance costs, affect the full range of insurance sectors operating in New York State. Overall, the increases in the Section 332 Insurance Department assessment will cost the insurance industry \$382 million per year, adding to the cost of almost all insurance lines offered to business and individual customers. This proposal is particularly offensive to the domestic life insurers that have maintained a century-long commitment to doing business in New York, employing upwards of 30,000 direct jobs in this state. Life insurers still maintain a strong domestic presence and commitment to the economy of the State, with companies headquartered in New York City, Binghamton, Syracuse and Albany. Likewise, the property and casualty insurance industry, like any other business, will have to eventually pass on at least a portion of its increased costs to its customers. This will have the unfortunate effect of harming New York policyholders by saddling them with higher insurance premiums.

Taxes on Business and Consumer Products and Services – In general, business pays about forty percent of all sales tax levies in the state, and the Executive Budget proposes a number of sales tax changes that will impact both the providers of these services, as well and business and residential customers of those services. Of particular concern are:

- The Section 18-A assessment mentioned earlier affects regulated telecommunications utilities as well, subjecting them to both direct new costs, and new competitive disadvantages since other, non-utility providers are exempt from these assessments.
- While not listed in the Executive Budget's revenue summaries, it proposes to allow municipalities to extend their utility gross receipts taxes to wireless telecommunication carriers. The added impact is another \$12.5 million per year on business and residential wireless bills.

- Much attention has given to the so-called "obesity tax," an estimated \$400 million per year assessment targeting a small segment of the state's business community, that will ultimately be borne by consumers as a *de facto* sales tax. The Business Council represents some of the nation's leading beverage companies, who would be significantly impacted by this proposal. Regardless of the policy arguments that have been offered in support of this tax, in our view, it is really just another symptom of the state's excessive spending, and its insatiable appetite for new revenues. We oppose its adoption. We note that, in addition to this tax, the Executive Budget would also subject the beverage industry to an expansion of the "bottle bill" to non-carbonated beverages, and a recapture of \$110 million or more annual in unclaimed deposits which have been used to defray compliance costs.
- An extension of the sales tax to cable and satellite television services, a proposal that could add an additional \$550 million onto the residential and business customers' bills in state and local taxes, and have a chilling effect on additional cable industry's capital investments – over \$3.3 billion in investments in New York State over the last 3 years.
- An extension of the state and local sales and use tax to purchases of prewritten software, digital audio and other "digital downloads," another \$15 to \$20 impact from state sales taxes along. Overall, the budget imposes over one half billion dollars in new taxes and assessments on information services.
- In a proposal that would significantly affect urban redevelopment efforts, reinvestment proposals, and other site reuse projects, the Executive Budget would eliminate more than \$120 million in sale tax exemptions for improvements that "substantially adds value to property or prolongs its useful life," but do not constitute construction of a new structure or an addition to an existing structure. Basically, this proposal imposes the state sales tax to major real estate rehabilitation projects, including the rehab of commercial space, hotels and other projects featured in urban reinvestments.

5. Economic Development Programs -- While we are a strong advocate for spending constraint, we note with concern that while most major spending categories are subject to limited spending reductions, the Executive Budget proposes a significant contraction in the state's economic development resources. While we are not opposing some major proposals, such as the elimination of some \$375 million in prior year commitments for economic development initiatives, we do have major concerns with some aspects of the Executive Budget.

In merging Economic Development and NYSTAR into ESDC, the budget would eliminate about forty percent of these agencies current combined staffing, and reduce their operating budgets by about \$11 million – cuts whose magnitude are not found in any other major state spending program affected by this budget.

It is unclear to us whether or how the newly structured ESDC can continue to perform its core economic development missions, including NYSTAR's special focus on fostering development in emerging technology sectors. In addition, the proposed budget would reduce "high tech funding," for programs including university based initiatives and university-business collaborations, by more than \$10 million per year.

As stated above, we support review of agency programs, and realignment of resources to assure efficient achievement of core missions. We believe the proposed reductions and restructuring of economic development programs are excessive, and come before any critical review of the affected programs.

Empire Zones - The Empire Zones program has been the basis for some of the largest capital investments in New York State in recent years. In many cases, its tax credits were necessary to offset uncompetitive high business costs in New York (taxes, particularly real property taxes; energy costs; and others) that otherwise discourage new in-state investments.

Governor Paterson's Executive Budget would require businesses currently receiving Empire Zone benefits to submit to a re-certification review. If the company could not demonstrate a 20 to 1 ratio of in-zone wages, benefits and capital investments over tax credits used, they would lose future Empire Zone credits, and forfeit any zone credits carried forward from previous tax years.

This proposal would adversely affect many zone participants, including some that have made multi-million dollar investments based on zone incentives.

Moreover, we believe this proposal would cause tremendous harm to the state's future economic development efforts, by calling into question the state's willingness to honor commitments. Council members have told us that *ex post facto* criteria for already-awarded investment incentives would make it less likely that they would make significant new investments in the state.

We agree that the state needs to rethink its economic development efforts, and assure that development incentives are cost-effective and are focused on strategic development objectives.

We believe that the most effective economic development program would be a more competitive business climate. As we have already discussed, New York needs to address its business tax burden, especially real property taxes; reduce energy costs, especially electric costs; health care costs; and others.

Unfortunately, the Executive Budget would take the state in the wrong direction, adding significantly to a wide range of business costs.

Recognizing that major business climate improvements will take time, we also believe the state needs to continue to offer economic incentive programs. Going forward, the state should consider multiple programs, each designed to address specific development objectives, including:

- Re-investment in existing business, to help retain valuable employers and high paying jobs. This could include QEZE-type benefits based on significant capital investment and job retention; enhanced investment tax credits; and/or by exempting investment-based credits from the state's alternative minimum tax.
- Redevelopment of distressed urban areas (the original focus of the empire zone program).
- Job creation at new and existing business; these could include new employee-based tax credits, and credits based on a percentage of state personal income tax revenues derived from new employees.
- Support of emerging technology sectors, with support for business growth, R&D, and commercialization of new products. This could include: expansion and extension of the Qualified Emerging Technology Company credit; pilot implementation of the "regional partnership" program adopted in 2005; a new capital grants program for emerging high tech companies (as proposed in the 2010 Executive Budget).

While we strongly oppose the Empire Zone recertification proposed in the Executive Budget, we look forward to working with the legislature and administration on new approaches to economic development in New York State.

6. Personal Income Tax – Various organizations are arguing for increased personal income tax levies on upper income New Yorkers. Sometimes referred to as the "millionaires tax," these proposals would affect a wide range of New Yorkers, including small business owners, so-called sub-S corporations (small businesses paying business taxes under the state's personal income tax law), and other highly productive taxpayers.

Despite arguments to the contrary, New York's personal income tax is progressive. The lowest fifth of taxpayers in terms of income pay no state or local income tax at all, and in fact receive a state refund under the Earned Income Tax Credit – a provision that has been supported by The Business Council. The effective tax rate on New Yorkers increases significantly as you move from the lowest income earners to the highest. For example, the effective state income tax rate on the highest one percent of earners is more than seven times that on the second quintile of taxpayers, and more than double that on the third quintile of taxpayers – those categories of taxpayers who could be fairly defined as the "middle class." In other words, taxpayers with progressively higher rates of income pay a progressively higher share of their income in state personal income taxes. High income earners pay a significantly higher share of their income in state income taxes than does the middle class.

As a final illustration, the top 4 percent of taxpayers in New York pay 55 percent of all personal income taxes. The top 25 percent of taxpayers account for more than 96 percent of all personal income tax liability.

With regard to specific proposals for increased personal income taxes, the Business Council opposes any permanent increase in any of the state's broad-based taxes during an economic recession because it is bad economic policy, and a bad message to send to current business and investors considering projects in New York State.

Any revenue adjustments should be targeted to address cyclical downturns in income, rather than impose a permanent increase in the state's tax burden.

Further, we strongly oppose any temporary increase in, or surcharge on, any of our broad based taxes without a prior commitment to significant spending restraint and other fiscal reforms to provide long term stability, and affordability, to the state's budget.

Again, New York's spending has increased to unsustainable levels; dealing with our current and future budget gaps requires significant adjustments on the spending side before we commit to new, burdensome taxes and fees.

7. MTA "Mobility Tax" – While not a budget issue, per se, we feel compelled to comment on the Ravitch Commission's recommendation for a payroll tax on employers in the twelve county MTA commuter district. This proposal, an assessment of \$.30 per \$100 of payroll, would impose \$1.5 billion in costs on the region's employers.

We are very concerned about the impact that this "tax on jobs" will have on the region's economic recovery. We are particularly concerned that the adoption of this assessment, without prior adoption of the other elements of the Ravitch Commission report – a 23 percent fare increase and new tolls on the East and Harlem River bridges – will provide an opportunity for an even higher jobs tax. Even with these over revenue options, we have little doubt that future MTA budget discussions will focus on an increase in any such "mobility tax."

Likewise, we are disappointed that the Ravitch Commission did not provide significant, specific cost containment recommendations. We cannot support any new broad-based MTA taxes without a commitment to spending constraint, public benefit reforms, and other efficiency and "core mission" assessments that we have already recommended for the overall state budget process.

8. Summary/Conclusion - As we said at the outset, this year's budget decisions will have long term ramifications for the state, as we work toward state and national economic recovery. I greatly appreciate the opportunity to share viewpoints and concerns of importance to The Business Council and our members. I look forward to any opportunity to follow up with you on any issue addressed in our testimony today.

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