Analysis of economic impacts of New York corporate income tax reform

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Executive summary

New York Governor Andrew M. Cuomo is proposing a tax relief package that would provide over $2 billion of annual tax reductions for New York State individual and business taxpayers. The tax relief proposal includes significant business tax changes to enhance New York's economic competitiveness, improve tax fairness by imposing more uniform taxes on all types of businesses, and simplify the business tax system to reduce compliance and administrative costs. Business tax recommendations include: 1) modernizing and simplifying the corporate franchise tax, 2) reducing the corporate franchise tax rate, and 3) reducing property taxes.

This paper, prepared by EY for the Public Policy Institute, the research affiliate of the Business Council of New York State, Inc., provides estimates of the expected benefits to New York State's economy and residents from the recommended business tax changes designed to simplify the tax system and improve New York's business tax competitiveness. A detailed model of the New York State economy is used to estimate the increased statewide economic activity, including jobs, personal income and capital investment, expected from the proposed business tax changes.

The specific business tax reductions included in the economic impact analysis are:

- A reduction in the corporate franchise tax rate from 7.1% to 6.5%. For Upstate manufacturers, the corporate franchise tax rate would be zero.
- Modernization and simplification of the corporate franchise tax, including the merger of the bank franchise tax into the general corporation franchise tax
- Adoption of a new business tax credit designed to offset 20% of the property taxes paid by manufacturers on real property

Table ES-1 presents the expected economic impacts from the package of business tax changes in 2019 and 2024. The impacts equal the difference in the economic measures in each year, before and after the proposed business tax changes. The economic impacts include the direct impacts on business taxpayers, as well as the multiplier effects throughout the New York economy. Key findings include:

- Compared to the forecasted level of employment under New York's current business tax system, the business tax changes are expected to add over 14,100 new jobs in 2019 and 17,800 new jobs in 2024.
- The state's real gross domestic product, the broadest measure of the size of the New York State economy, could expand by over $1.8 billion in 2019 and $2.7 billion in 2024.
- By reducing the tax burden on the income from new investments in machinery, equipment and buildings, the tax reductions will increase the rate of return on capital investments in New York and stimulate investment. As a result, annual real capital investment is expected to be $800 million higher in 2024 as a result of the proposal.

- The combined effect of increased employment and increased labor productivity due to the higher stock of capital equipment is expected to generate substantial increases in the personal income received by New York residents. Personal income is expected to increase by $1.3 billion in 2019 and $2.1 billion in 2024.

- State and local governments in New York will also benefit from the stronger state economy as tax bases expand with increases in consumer spending, household and business incomes, and taxable property values. The stronger economy is expected to generate almost $740 million in additional state and local taxes by 2024.

Table ES-1. Dynamic New York State economic impacts of the proposed business tax changes

	Economic impacts	
Economic measures	**2019**	**2024**
Total employment (number of jobs)	14,100	17,800
Personal income ($millions)	$1,330	$2,133
Gross domestic product (millions of $2005)	$1,755	$2,707
Real capital investment (millions of $2005)	$526	$799
Additional state & local taxes ($millions)	$607	$737

Source: EY calculations based on simulations using the REMI New York State economic model.

Analysis of economic impacts of New York corporate income tax reform

Introduction

New York Governor Andrew M. Cuomo is proposing a tax relief package that would provide over $2 billion of annual tax reductions for New York State individual and business taxpayers. The tax relief proposal includes significant business tax changes to enhance New York's economic competitiveness, improve tax fairness by imposing more uniform taxes on all types of businesses, and simplify the business tax system to reduce compliance and administrative costs. Business tax recommendations include: 1) modernizing and simplifying the corporate franchise tax, 2) reducing the corporate franchise tax rate, and 3) reducing real property taxes.[1]

This paper, prepared by EY for the Public Policy Institute, the research affiliate of the Business Council of New York State, Inc., provides estimates of the expected benefits to New York State's economy and residents from the Governor's recommended business tax changes. A comprehensive model of the New York State economy is used to estimate the increased statewide economic activity, including jobs, personal income and capital investment, expected from the proposed business tax changes.

The following sections describe the proposed business tax changes, discuss the objectives and guiding principles of tax reform, and present the estimates of the expected benefits to New York State's economy and residents from the Governor's recommended business tax changes.

Components of the Governor's business tax proposal

The Governor's business tax proposal includes merging the bank franchise tax (Article 32) into a substantially modified general corporation franchise tax (Article 9-A).[2] In addition to the unification of Articles 9-A and 32, key components of the tax reform proposal include:

- The adoption of an economic nexus standard
- Replacement of the current combined reporting system with mandatory water's edge unitary combined reporting with a more than 50% stock ownership test

[1] The Governor's recommendations incorporate a number of the business tax changes recently recommended in the final reports of two state commissions: the New York State Tax Relief Commission and the New York State Tax Reform and Fairness Commission. See New York State Tax Relief Commission, *Final Report* (December 2013) and New York State Tax Reform and Fairness Commission, *Final Report* (November 2013).

[2] The specific tax reform changes described in this section are based on additional information from the New York Department of Taxation and Finance on the specific components of the corporate franchise tax reform packages recommended by the Tax Fairness and Tax Relief Commissions. The description of the components of the corporate tax reform recommendations included in this report may change as more details of the Governor's recommendations become available.

- Selected tax base changes include:
  - Elimination of the exemption for income from subsidiary capital; this income would be treated as either taxable business income, exempt investment income or other exempt income
  - Modification of the definition of investment income and the adoption of an exemption for investment income net of attributable interest expenses
  - Expanded NOL provisions with credits for pre-tax reform NOLs

- Article 9-A's existing single sales factor apportionment formula will apply to all filers under the reform proposal along with market (customer) based sourcing of sales, including new sourcing rules for income from qualified financial instruments

- Elimination of the Article 9-A minimum taxable income base and tax on subsidiary capital, and the Article 32 alternative entire net income tax base, taxable assets base and fixed dollar minimum tax

- An increase in the amount of the fixed dollar minimum tax under the modified Article 9-A tax

In addition to these extensive changes in the corporate franchise tax structure, the Governor's business tax recommendations include:

- A reduction in the corporate franchise tax rate for most filers from 7.1% to 6.5%

- A reduction in the corporate franchise tax rate to zero for Upstate New York manufacturers

- A tax credit equal to 20% of annual property taxes against corporate income taxes for manufacturers

Benefits of New York corporation tax reform

Broad tax policy principles have served as a guide in the development of the business tax recommendations advanced by the Department of Taxation and Finance (the "Department"), the Tax Reform and Fairness Commission and the Tax Relief Commission. These principles include: 1) *horizontal equity* to treat taxpayers uniformly, 2) *simplicity* to reduce compliance and administrative costs and increase voluntary compliance, and 3) *economic competitiveness* to sustain New York State economic growth.

Horizontal equity

The horizontal equity principle can be described as providing a level playing field. The objective is to apply similar tax provisions to taxpayers that are similarly situated.

This principle is unattainable under New York's current corporate franchise tax system because taxpayers engaged in similar economic activities (e.g., lending or leasing) can be subject to Article 9-A or Article 32. Thus, such taxpayers, engaged in the same economic activities, are subject to different tax bases, apportionment methodologies and combined group filing requirements. The result is significant differences in effective tax rates on income from similar activities. The merger of Article 32 into a modified Article 9-A creates a level playing field by providing more uniformity in the franchise tax system.

Simplifying the tax system

The corporate franchise tax reform recommendations provide substantial benefits in reduced compliance costs for both taxpayers and the state. The integration of Articles 9-A and 32 contributes to both the simplicity and ease of compliance and administration principles by:

- Reducing the number of returns filed by groups of affiliates that are currently filing under both Article 32 and Article 9-A. The proposal also reduces the number of tax bases that must be calculated on each return.

- Simplifying the determination of which affiliated subsidiaries are to be included in a combined return. Under current law, among other requirements, combination is required under Article 9-A if there are "substantial intercorporate transactions" among the related corporations. A Department memorandum (TSB-M-08(2)C) describing how to determine if there are substantial intercorporate transactions notes that it depends upon "the facts and circumstances of all activities and transactions between related corporations." It then describes a very complicated and difficult to apply, 10-step analysis, unique to New York, which must be followed to determine if a combined report is required and, if so, which corporations are to be included.

  Subsequent to issuing the memorandum, the Department promulgated regulations that include most of the same complicated rules unique to New York. The tax reform proposal, on the other hand, adopts combined return features that are used in most states that require unitary combined reporting.

- Changing the calculation of NOLs to remove complicated restrictions that make it difficult to accurately determine allowable NOLs.

- Applying the same apportionment formula and sourcing rules to all companies engaged in similar economic activity.

- Eliminating taxpayer uncertainty and administrative difficulties for the Department related to the determination of the appropriate filing status (Article 9-A or Article 32) for taxpayers in the financial services industry.

These changes should reduce both the cost of compliance and administration, as well as audit disputes and litigation expenses, for taxpayers currently subject to Article 9-A or Article 32, as well as for the state. While the cost savings may be substantial to both the Department of Taxation and Finance and to taxpayers, there is no current estimate of the dollar amount of these savings.

Improving New York's business tax competitiveness

A key objective of the business tax reform recommendations is to increase New York's business tax competitiveness relative to other states. The proposed tax reforms would increase tax competitiveness for taxpayers that have significant employment and capital investments in New York in several ways:

- The application of the single sales factor based on destination sales to current Article 32 taxpayers would reduce the tax base for taxpayers with significant in-state employment and capital. The single sales factor formula would also reduce any increase in franchise taxes triggered by adding new investments and jobs in New York. Article 9-A taxpayers were provided with the competitive benefits of this apportionment formula change in 2005. Single sales factor apportionment for business taxes has been adopted by 18 other states, including California, Connecticut, Texas, Ohio, Pennsylvania, Illinois, Michigan, Maryland and New Jersey.

- The corporate tax rate under the modified Article 9-A franchise tax recommendation would be reduced from 7.1% to 6.5%, an 8.5% rate reduction. The rate would be reduced to zero for Upstate manufacturers. For a large number of taxpayers, the tax rate reduction would exceed any additional taxes resulting from proposed modifications in other components of the franchise tax structure.

In contrast, there may be net tax increases for other taxpayers due to:

- The adoption of the economic nexus standard which subjects corporations with greater than $1 million in New York State revenues to the franchise tax. This base increase would affect firms selling into New York with minimal employment and property in the state.

- The combined reporting changes would add additional subsidiaries to the combined group. The net tax impact in this case will depend upon the profitability per dollar of sales of the added corporations compared to this ratio for members of the combined group under current law. If the additional subsidiaries are relatively more profitable, the new combined group's taxes could increase.

Although the business tax recommendations may increase tax liabilities for some taxpayers in selected industries, substantial business tax reductions for most business taxpayers should stimulate additional in-state economic activity.

Business tax competitiveness should also be evaluated in terms of the burden of New York business taxes relative to other states. Over the last two years, for example, there has been a definite trend towards lowering the level of state corporate income taxes to improve business tax competitiveness. These tax law changes include the adoption of single sales factor apportionment formulas and reductions in corporate income tax rates. For example, tax rate cuts have been adopted by legislatures in Idaho, Indiana, Massachusetts, New Mexico, North Carolina, North Dakota and West Virginia. Tax rate cuts exceeded 20% in Indiana, New Mexico and North Carolina. Single sales factor apportionment has been adopted most recently in California, New Jersey, New Mexico, South Carolina and Virginia (for manufacturers).

Economic impact analysis

As noted above, it is reasonable to expect that the Governor's business tax reform proposal will increase New York's business tax competitiveness and result in stronger state economic growth. The following analysis provides initial estimates of the potential benefits of the recommendations for franchise tax reform, franchise tax rate reductions and the business property tax credits (as described above) in terms of additional jobs, incomes and capital investment in New York.[3]

Economic impact modeling assumptions

The economic impact analysis begins with Department estimates of the net change in corporate franchise tax collections from the Governor's business tax recommendations. The Department also developed additional information on the net change for Article 9-A taxpayers and Article 32 taxpayers. These "static" revenue change estimates are the starting point for EY's "dynamic" economic impact analysis.[4]

The Regional Economic Models, Inc. (REMI) model of the New York State economy was used to estimate the expected economic impact on the state's economy from the Governor's business tax proposals. The economic impacts include the direct effects on business taxpayers, as well as the "multiplier" effects throughout the New York economy. The revenue impact estimates, with an EY modification described in the next paragraph, were used as inputs to the REMI model.

To more accurately estimate the dynamic economic impacts of the change in the apportionment formula for Article 32 taxpayers, EY estimated the division of the net change in Article 32 into 1) an estimate of aggregate tax increases, and 2) an estimate of aggregate tax decreases. The two tax change "buckets" are modeled as having different impacts on the New York economy due to the differences in relative employment and investment levels in the state for taxpayers in the two groups.[5]

[3] The Governor is also proposing the immediate elimination of the 2% Temporary Utility Assessment (18-A) that applies to selected industrial utility purchases. This change will lower the cost of doing business in New York and increase the State's competitiveness. The economic benefits of this tax change are not included in the economic impact analysis.

[4] The revenue impact estimates accompanying the Governor's recommendations are reported for the fully phased in business tax changes. EY used different constant rates of growth for components of the recommendations to project the changes beyond the state's current tax forecast. In modeling the economic impacts of the recommended business tax changes, the fully phased in amount of tax changes were used as the starting point.

[5] The static revenue estimates for the impact of applying the single sales factor apportionment formula to Article 32 taxpayers were based on earlier tax policy simulation runs prepared by the New York City Department of Finance. These runs provided information on the ratio of aggregate tax increases and aggregate tax decreases from the change in apportionment. EY developed independent estimates from U.S. Census, *Enterprise Statistics*, of the proportion of tax increases that would be paid by taxpayers with relatively low ratios of New York payroll and property to New York sales. These are the taxpayers that may pay higher taxes due to the change in the apportionment formula.

Economic impact results

Table 1 provides a high-level overview of the estimated statewide economic impacts of the Governor's business tax recommendations. The results are summarized for 2019 and 2024, assumed to be 5 and 10 years after the initial tax cuts.

As shown in Table 1, the recommendations add an estimated 14,100 jobs by 2019; the new jobs increase to almost 17,800 by 2024. These are the estimated number of additional jobs in the New York state economy that would be added to the forecast level of employment that is expected without the tax changes. It is important to note that the job increase is measured by comparing the employment level in each future year before and after the recommended business tax changes. The job changes are not being measured relative to the level of jobs in 2014.

Table 1. Dynamic New York economic impacts of the Tax Relief Commission's recommended business tax changes

	Economic impacts	
Economic measures	**2019**	**2024**
Total employment (number of jobs)	14,100	17,800
Personal income ($millions)	$1,330	$2,133
Real disposable personal income (millions of $2005)	$1,290	$1,665
Gross domestic product (millions of $2005)	$1,755	$2,707
Real Capital investment (millions of $2005)	$526	$799
Additional state & local taxes ($millions)	$607	$737

Source: EY calculations based on REMI model of the New York economy simulations.

The recommended corporate franchise tax reforms, franchise tax rate cuts, and property tax credits have a significant impact on personal income of New York residents. New York personal income increases by over $1.3 billion in 2019 and by over $2.1 billion in 2024. This is the estimated additional income received by New York residents as a result of the tax changes.

Table 1 also shows that the combination of business tax changes results in substantially higher levels of capital investment (machines, equipment and buildings) in New York State. Real capital investment increases by $526 million in 2019 and $800 million per year by 2024.[6] This additional capital investment is an important source of increases in worker productivity and compensation over time.

[6] By 2019 the job and personal income increases equal 0.1% of the economy-wide figures before the business tax reductions; the increase in capital investment is close to 0.4%.

The increase in personal income generates additional state and local income, sales, property and other taxes. Estimates of this dynamic tax feedback effect suggest that the additional taxes may offset roughly one-third of the initial static revenue loss from the business tax reductions by 2019. While the state revenue estimators do not recognize this dynamic feedback effect in bill analyses prepared for legislators, it is an important public-sector benefit from a stronger New York economy.

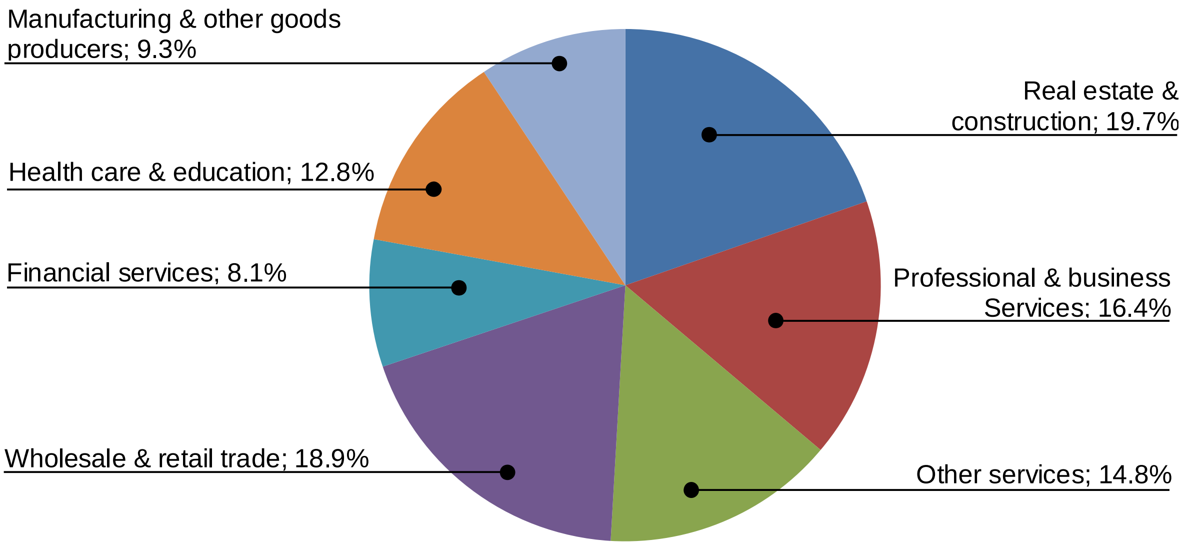
Table 2 and Figure 1 show that employment increases due to the proposed business tax changes are spread widely across all major sectors of the New York economy, a result of the multiplier effects throughout the state economy. The table presents the 2019 distribution of the projected new private-sector employment by broad industry sectors. The shares range from almost 20% in retail and wholesale and real estate and construction industries to just over 8% in the financial services sector.

Table 2. Distribution of New York employment increases by major industry sector

Industry category	**2019 distribution**
Real estate and construction	19.7%
Wholesale and retail trade	18.9%
Professional and business services	16.4%
Other services	14.8%
Health care and education	12.8%
Manufacturing and other goods producers	9.3%
Financial services	8.1%
Total employment change	100.0%

Source: EY calculations based on REMI model of the New York economy simulations.

Figure 1. Shares of 2019 employment increases by major industry sector



Source: EY calculations based on REMI model of the New York economy simulations.

Understanding the economic impact results

One reason for the strong economic impacts from the business tax proposal is that the business tax reductions are concentrated in industries that have relatively high economic multipliers. Business tax reductions in these industries can have strong spill-over effects that increase employment and investment throughout the New York economy.

Table 3 presents estimates of the multiplier impacts for an expansion of New York employment in each major industry. The estimates are based on REMI model runs for New York State. The multiplier measures the number of total new jobs that result from an initial new direct job added by a firm in each industry. For example, a multiplier of 3.0 in a given industry indicates that each new direct job in that industry results in three total new jobs in the state. In addition to the initial direct job, economic activity related to additional purchases from instate suppliers, as well as additional consumer spending on instate goods and services from higher worker incomes, add two more jobs throughout the New York economy. The jobs multiplier in this example is 3, the total new economy-wide jobs per one new direct job in a specific industry.

Table 3 shows that the information and financial service industries have multipliers greater than 3.0 with the manufacturing and management of companies (headquarters) sectors having multipliers greater than 2.0.

Table 3. New York State job multipliers for each new job added by major industry

Industry	Job multiplier
Information	3.9
Financial services	3.3
Real estate	2.5
Management of companies	2.4
Manufacturing	2.3
Wholesale trade	2.1
Professional, scientific & technical services	1.9
Retail trade	1.7
Construction	1.6
Transportation and warehousing	1.5
Health care	1.4
Arts, entertainment, and recreation	1.4
Other services	1.3
Educational services	1.3

Note: Multiplier estimates based on REMI New York State model runs adding 1,000 direct jobs to each industry.

High job multiplier values are due to several factors including an extensive network of instate suppliers of goods and services to an industry and high wages and salaries in an industry that result in significant spending on consumer goods and services provided by instate firms.

Table 4 provides estimates of the average New York wages and salaries by major industry compared to the statewide average of 100%. For example, annual wages in the management of companies industry is 279% or almost 2.8 times higher than the all-industry average of 100%. The above-average levels of annual wages in the management of companies, financial services, professional, scientific, & technical services, and manufacturing industries results in relatively high additional consumer spending when jobs are added to these industries.

Table 4. Average annual New York wages, relative to statewide average, by major industry group, 2014
State-wide average = 100%

Industry	Relative average annual wages
Management of companies	279%
Financial services	259%
Information	177%
Professional, scientific & technical services	135%
Manufacturing	119%
State-wide average	***100%***
Construction	93%
Health care	82%
Educational services	75%
Transportation and warehousing	70%
Retail trade	56%
Other services	54%
Arts, entertainment, and recreation	46%

Source: The wage data is part of the economic data base in the REMI model of the New York State economy.