

SUMMARY OF FINDINGS

The purpose of this study is to help policy makers and the public to understand the current debate over tax policy and school funding in New York. The study has three broad goals:

- First, the report provides a detailed **menu of revenue-raising options** that could be used to adequately fund public services in New York.
- Second, the report looks at the **tax fairness impact** of various tax reform options on New York taxpayers at different income levels.
- Third, the report analyzes the **impact on economic development** of these tax options.

This introductory chapter provides a “road map” for the study, describing the contents of each chapter.

Basic Tax and Education Policy Concepts

This report deals with two public policy areas—state tax policy and education finance. **Chapter One** provides a brief introduction to important principles of tax and education policy used in the study. Tax policy principles covered in this chapter include fairness, base-broadening, adequacy, exportability, neutrality and economic development. The chapter also explores the principles of adequacy and equity as they affect education funding, and provides a basic introduction to tax incidence analysis.

About the CFE Case

New York is no stranger to fiscal crises. But the New York Court of Appeals’ June 2003 ruling that the current education system does not provide students with a “sound basic education” heralded the beginning of a new and important era in the state’s tax reform saga. **Chapter Two** provides a detailed analysis of the CFE case and its explanation of what a “sound basic education” means in New York.

Chapter Two also looks at estimates of the policy changes that will be required in order to improve New York education, reviews estimates of the cost of implementing these changes, and surveys the experience of several other states that have attempted court-ordered school funding reform, with the goal of gleaning lessons that might help achieve adequacy in New York.

The Current New York Tax System

Chapter Three provides a summary of the current tax structure. The chapter shows that the New

York tax system is *regressive*. That is, it requires low-income taxpayers to pay more of their incomes in taxes than the very wealthy. This is primarily due to the state’s heavy reliance on sales and excise taxes.

Chapter Three also demonstrates that while New York relies more heavily on local tax revenues than most states, taxing districts outside of New York City rely on a relatively undiversified tax base.

New York’s reputation as a “high tax” state is blunted somewhat when the interaction between federal and state taxes is taken into account. Chapter Three explains how this interaction works, and discusses impending threats to this important mechanism for tax exporting.

Personal Income Taxes

The personal income tax plays a pivotal role in the New York tax system. The tax helps to offset the regressive impact of New York’s consumption and property taxes. Yet income tax cuts enacted in the past quarter century have dramatically reduced the fairness of the tax—and have made the New York tax system more regressive overall. Moreover, the tax base contains loopholes that further reduce the overall progressivity of the tax, while limiting the state’s ability to fund education. **Chapter Four** describes the factors limiting the yield and progressivity of the New York income tax and discusses options for tax relief to offset the impact of income tax hikes on low- and middle-income New Yorkers.

Corporate Income Taxes

New York’s corporate income tax base is being eroded—partially due to poorly targeted tax breaks enacted by New York lawmakers, but partially due to creative accounting by corporations seeking to minimize their tax liability. **Chapter Five** assesses the most harmful corporate tax loopholes used in New York and suggests alternatives for broadening the tax base. The chapter also discusses the importance of corporate tax disclosure as a means of diagnosing the health of the tax in the future.

Sales and Excise Taxes

New York relies less on sales and excise taxes than most other states. The state’s consumption tax as a share of income was just 36th highest nationally in 2002. Yet, as **Chapter Six** shows, this low-yield tax is

the result of a comparatively high tax rate and a comparatively narrow tax base. The state allows a host of sales tax exemptions that discriminate in favor of some taxpayers and against others—in ways that reduce the overall fairness of the tax system.

Closing these loopholes would broaden the base of the sales tax, increasing its perceived fairness—but would also make the tax system more regressive. For this reason, Chapter Six also discusses options for low-income sales tax relief.

Property Taxes

Like most states, New York relies on locally levied property taxes as a primary mechanism for funding elementary and secondary education. As shown in **Chapter Seven**, New York has the 10th highest property taxes in the United States, almost 25 percent above the national average. But the state's ongoing fiscal difficulties mean that efforts to reduce the burden of property taxes should focus on targeted, cost-effective measures.

Chapter Seven describes several tax reforms that could help achieve this, including the creation of a statewide property tax and the enhancement of an existing low-income “circuit breaker” tax credit.

The chapter also discusses weaknesses in the main tax relief mechanism used by the state, the STAR homestead exemption. STAR is poorly targeted and expensive—and restricts the state's ability to provide targeted tax relief to those homeowners and renters for whom the New York tax system is most burdensome.

Other Revenue Sources

The lion's share of any new tax revenues are likely to come from the major tax sources already levied by New York. But several lesser revenue sources could be harnessed to help fund education. **Chapter Eight** looks at several minor revenue sources, including the estate tax, gambling revenues, and a stock transfer tax, and assesses the virtues and shortcomings of each as revenue-raising solutions for New York.

Tax Reform Options

How would the revenue-raising strategies outlined in this report affect tax adequacy and tax fairness? **Chapter Nine** describes 26 tax changes that can be used as “building blocks” for revenue raising. Distributional and revenue analyses are provided.

Because none of these building blocks will be suffi-

cient to fund adequacy on its own, the chapter also presents four packages of tax reform options that could be adequate to fund New York education.

Economic Impact of a Sound Basic Education

One reason that lawmakers frequently give for resolving fiscal crises through spending cuts rather than tax hikes is the alleged negative impact of tax increases on state economies. But the sheer scale of the state's current fiscal shortfall means that policy makers may find tax hikes unavoidable. **Chapter Ten** shows that a balanced analysis of the impact of tax hikes—that is, one that takes into account the positive impact of public spending alongside the negative impact of tax hikes—reveals that adequately funding education in New York State can have a positive impact on the state's economy, and that these tax and spending changes must be properly structured to maximize the positive impact on economic growth in New York. The analysis shows that funding education through an income tax hike would have the most positive impact on the state's economy.

The chapter also discusses the broader literature on the economic development impact of tax increases, and finds little empirical evidence that taxes have a negative impact on economic development.

Building Support for Tax Reform

Implementing wholesale tax reform is rarely easy. **Chapter Eleven** describes strategies for informing the public about available tax reform options, and the impact of these options on tax fairness and adequacy.

The chapter discusses two sources of information that a growing number of state governments now regularly provide: tax incidence analyses and a tax expenditure report. New York is among the dozens of states that currently do not produce a regular tax incidence report. Like many states, New York does publish a tax expenditure report that lists many of the special tax breaks carved out of the state tax code—but the state's report could do more to help lawmakers evaluate the usefulness of these tax breaks.

The chapter discusses the importance of public opinion of tax policy options—and shows that public evaluations of these options depend critically on showing the linkage between taxes and spending. In evaluating public opinion on tax issues, lawmakers should critically evaluate the wording of polls to see whether the questions asked make this linkage clear.