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February 26, 2018

Mr. David Kautter
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220

Mr. Kautter,

As you know, the limitation on state and local tax deductibility remains a concern to many taxpayers in New York State. The proposed Executive Budget in New York State contains provisions which would amend the state tax law in response to the recently enacted Tax Cuts and Jobs Act. Attached hereto are descriptions of the state proposal from the Executive Budget presentation.

One of these proposals would allow taxpayers to make charitable contributions to new state related entities for health and education-related costs, allowing taxpayers to retain most of the existing deductibility of such contributions. The proposed state tax provisions are intended to replace traditional income tax payments to the State which are no longer fully deductible. The New York proposal and similar plans in other states are apparently modeled in part on existing state programs which award tax credits to residents in exchange for contributions to designated charitable causes. In these instances, I'm advised that the IRS has treated such contributions as deductible under federal law.

Specifically, these contributions would be made to new entities which would turn over such contributions to the state's general fund budget. Similar options would be made available to school districts and municipalities looking to assist taxpayers in retaining deductibility for local tax payments to localities and school districts.

I have had many questions from constituents as to whether the state initiative will be compliant with federal law and regulation governing charitable deductions. Would such payments or contributions meet the test for a charitable deduction since presumably the taxpayer is receiving benefits from the governmental units and school districts for the "contributions" donated?

This matter is of great public interest in a number of states besides New York, including California, New Jersey and Connecticut among others. Please advise whether the IRS has begun evaluating

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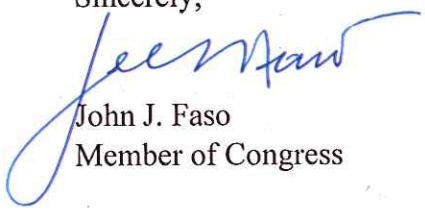
the validity of these and similar proposals? I believe that it is important that the Treasury and the IRS issue guidance or a formal opinion letter whether taxpayer contributions to state authorized trust funds, partially reimbursed by credits reducing state and local income taxes, will be considered deductible for federal tax purposes.

I would appreciate your timely response as these proposals are now under consideration by the state legislature in Albany.

Please feel free to contact me to discuss this matter further.

Sincerely,



John J. Faso
Member of Congress

Summary of Proposed Tax Reforms

FY 2019 Executive Budget
30-Day Amendments

Andrew M. Cuomo, Governor
Robert F. Mujica Jr., Budget Director

February 2018

Summary of Proposed Tax Reforms

On December 22, 2017, President Donald J. Trump signed into law sweeping changes to the federal tax system. The new federal law has a disproportionate and negative impact on the State of New York. Absent changes to the State's tax code, the law's limitations on the deductibility of state and local taxes will cost New York's taxpayers an additional $14.3 billion per year and risk undermining the progressivity of the State's tax system, the investments and services that the State provides for its residents, and the competitiveness of New York's economy over the long term.

The elimination of full state and local deductibility rolls back a basic tenet of federal tax law that has been part of the modern federal income tax since it was created in 1913, more than a century ago. States like New York have designed their tax systems according to this principle, which takes state taxes into account before federal taxes. With the transformation of the federal tax system, it is incumbent on New York to consider adjusting its own tax structure accordingly.

Moreover, because the State's income tax system conforms to the federal system in numerous ways, federal changes will have significant flow-through effects on the state taxes that New Yorkers pay and the revenues the State collects. New York must consider these flow-through impacts and decouple from federal tax law when doing so is in the best interest of the State and its residents.

At the Governor's direction, the New York State Department of Taxation and Finance produced a report outlining options for state tax reform in response to this new federal law. The report offered a series of proposals for consideration and comment, all designed to advance four primary goals: first, to promote fairness for New York's taxpayers; second, to protect the progressivity of New York's tax system and the investment's and services that benefit the State's residents and beyond; third, to protect and enhance the State's economic competitiveness; and lastly, to maintain the State's short- and long-term revenue base.

After further study and extensive consultation with experts and stakeholders from state and local government, academia, and the private sector, the proposed reforms were found to be viable options for protecting New Yorkers. Today, the Governor is advancing the following steps:

I. Implement an Optional Employer Compensation Expense Tax System
II. Create Additional Opportunities for Charitable Contributions to Benefit New Yorkers
III. Decouple from the Federal Tax Code to Protect New York Taxpayers from Tax Increases
IV. Pursue an Unincorporated Business Tax to Preserve Deductibility for Pass-Through Businesses

Together, these proposals have the potential to keep billions of dollars in the pockets of New Yorkers every year.

I. Implement an Optional Employer Compensation Expense Tax System

While the new tax law denies state and local tax deductibility to individuals, employer-side payroll taxes will remain deductible. A new optional payroll-based Employer Compensation Expense Tax (ECET) therefore serves as a vehicle by which to preserve deductibility for New York State taxpayers.

Legislation will allow employers to opt-in to a new ECET system. Employers that opt-in would be subject to a 5 percent tax on all annual payroll expenses in excess of $40,000 per employee. This tax would be phased in over three years beginning on January 1, 2019 according to the following schedule: 1.5 percent in the first year, 3 percent in the second year, and 5 percent in the third year.

The progressive personal income tax (PIT) system would remain in place, and the ECET would be coupled with income tax relief for employees in the form of a corresponding tax credit on their wages. Under this new system, employees would be expected to experience an increase in take-home pay as their federal tax liabilities decline. The impact on the State Financial Plan is expected to be revenue neutral.

When fully phased in, the new system could generate up to roughly $4 billion in federal tax savings for New Yorkers per year. The Department of Taxation and Finance estimates that a taxpayer (married filing jointly) making $150,000 in wage income would see a federal income tax reduction of roughly $1,200 as a result of the ECET.

To opt-in, employers would make an annual election to participate in this alternative system. In order to be effective, the election must be made by (i) unanimous consent of all owners of the employer at the time the election is made if the employer is not a corporation; (ii) if the employer is a for-profit or not-for-profit corporation, by any officer or manager of the employer who is authorized under the law of the state where the corporation is incorporated or under the employer's organizational documents to make the election and who represents to having such authorization under penalties of perjury; (iii) if the employer is a trust, by unanimous consent of all the trustees; or (iv) if the employer is a governmental entity, by the chief executive officer of such governmental entity. The election must be made by October 1st of any calendar year and will take effect for the immediately succeeding calendar year, starting on October 1, 2018. If an election is made after October 1st of a calendar year, it will first take effect in the second succeeding calendar year.

Employers who elect to participate would be obligated to pay the new ECET on employee wages in excess of $40,000. In addition, the administration will work with the legislature and stakeholders to design incentives to help offset any administrative costs of ECET implementation.

The ECET proposal is designed to be revenue neutral for the State. As ECET collections rise, PIT collections are expected to fall by a comparable amount. The Financial Plan does not include any estimates for ECET revenues as employer opt-in rates will not be known until October 2018. The Division of the Budget expects to include estimates as opt-in rates and other information become known.

New York State is committed to taking the steps necessary to maintain the credit quality of the State PIT Revenue Bond Program, which has been the primary financing vehicle used to fund the State's capital program since 2002. As of January 15, 2018, New York State had $34.8 billion of state PIT Revenue Bonds outstanding, all of which are secured by 25 percent of state PIT receipts, net of refunds. In anticipation of any reduction in the level of PIT collections as a result of the Employer Compensation Expense Tax system, the legislation includes a corresponding increase in the amount of PIT dedicated to the payment of principal and interest on State PIT Revenue Bonds from 25 percent to 50 percent. In addition, payroll tax revenues will be added as a supplemental source of security for State PIT Revenue Bonds.

The State expects that a new ECET system has the potential to impact individuals' eligibility for certain personal income tax credits and public programs. At the Governor's direction, the Department of Taxation and Finance and the Division of the Budget will develop recommendations to make adjustments to income thresholds for tax credit and other program eligibility in order to minimize any adverse impacts to individual taxpayers resulting from the new ECET. The Executive is also open to authorizing the City of New York and the City of Yonkers to create an ECET to help preserve deductibility for city taxpayers.

II. Create Additional Opportunities for Charitable Contributions to Benefit New Yorkers

Taxpayers have traditionally been able to reduce their income tax liability by taking deductions for contributions to certain organizations, including charities and federal, state, local, and Indian tribal governments. The new federal tax law retains and raises the limit on charitable deductions, increasing the contribution limit for 2018 from 50 percent to 60 percent of modified Adjusted Gross Income (AGI).

New York State will build on the expanded federal deduction by encouraging additional charitable giving to the State that would be deductible from federal taxable income for those who itemize their deductions. Specifically, Governor Cuomo's 30-Day Amendment creates two new state-operated charitable funds to accept donations for the purposes of improving health care and education in New York. Taxpayers who itemize deductions could claim these charitable contributions as deductions on their federal and state tax returns. Any taxpayer making a donation could also claim a state tax credit equal to 85 percent of the donation amount for the tax year after the donation is made.

The legislation also authorizes school districts, counties, towns, cities, and villages to create charitable funds for education, health care, and other charitable purposes. Donations to these funds would provide a reduction in local property tax bills (via a local credit) equal to 95 percent of the donation. The Executive is also open to authorizing a tax credit against New York City PIT and the City of Yonkers PIT so that taxpayers in those cities could claim a credit for contributions towards a new charitable fund.

The Executive Budget Financial Plan does not include any estimates for charitable contributions. Charitable giving is not expected to have a measurable impact on the Financial Plan in FY 2019. Donations made in TY 2018 are not expected to be disbursed for charitable purposes until FY 2020, and the cost of the state tax credit will not be incurred until TY 2019. However, changes in taxpayer behavior could affect the timing of PIT receipts. The Division of the Budget expects to include

estimates on charitable giving in future Financial Plan updates, once activity on donations can be observed.

III. Decouple from the Federal Tax Code to Protect New York Taxpayers from Tax Increases

Because the State's income tax system conforms to, and interacts with, the federal system in numerous ways, federal changes will have significant flow-through effects on the state taxes that New Yorkers pay and the revenues the State collects. Governor Cuomo will take the necessary steps to decouple from federal law in order to protect taxpayers who face tax increases. In aggregate, these reforms are expected to generate more than $1.5 billion in tax savings per year.

- Decouple from Federal State and Local Tax Deduction Cap. The federal law caps the aggregate itemized deduction for state and local taxes, including property taxes, at $10,000. Because New York requires state itemized deduction calculations to start with the deductions claimed on the companion federal return, the new federal cap on state and local tax deductions has the potential to substantially lower the amount of itemized deductions claimed at the state level. Governor Cuomo is proposing to decouple from federal law in order to avoid a $441 million state tax increase that would result from the flow-through of the new federal cap to state income tax returns.

- Maintain the Standard Deduction for Single Filers. Under current law, New York offers state dependent exemptions that can be used to reduce adjusted gross income for state tax purposes. However, the state exemption can be claimed only for dependents, not for taxpayers and spouses. In 2018, the state dependent exemption is equal to $1,050.

  Federal suspension of personal exemptions is not expected to impact the State's dependent exemption. However, suspension of federal personal exemptions will have a direct impact on the availability of the state standard deduction for single filers. Under current state law, a taxpayer is eligible for the standard deduction for single filers only if the individual "is not married nor the head of a household nor an individual whose federal exemption amount is zero...." This language is intended to preclude joint filers, head of household filers, and taxpayers that are claimed as dependents on other taxpayers' returns from claiming the single filer deduction ($8,000 for 2018). Absent a state statutory change, single taxpayers will be required to claim the lower deduction intended for dependent filers ($3,100 in 2018).

  Legislation will maintain the state standard deduction for single filers, generating an expected $840 million annual tax savings for New Yorkers.

- Decouple from Other Itemized Deduction Limitations. New York State tax law requires taxpayers who have claimed the standard deduction on their federal income tax return to also claim the standard deduction on their state return. The higher federal standard deduction under the new law will lead fewer taxpayers to claim itemized deductions on their federal returns. As a result, the State will have more taxpayers claiming the standard deduction and fewer itemized deductions overall. The legislation proposes eliminating the requirement that taxpayers may only itemize deductions on their New York return if they itemize on their federal

return. In addition, the legislation decouples from other changes to federal deductions imposed by the new law.

- Corporate Taxes. Legislation will clarify that taxpayers may not reflect the partial federal deduction for foreign income deemed repatriated on their State tax return.

IV. Pursue an Unincorporated Business Tax to Preserve Deductibility for Pass-Through Businesses

The income of certain types of businesses—income derived from profits from a partnership, for example—is "passed-through" to the business's owners, who must pay personal income taxes on that business income. Under the new federal tax law, state and local personal income taxes on this pass-through income would be subject to the new $10,000 deduction limitation. However, taxes paid in the operation of a trade or business at the entity level continue to be deductible as a cost of doing business.

Consistent with the options outlined in the Department of Taxation and Finance Report, Governor Cuomo will pursue reforms to apply a deductible business tax on pass-through businesses, or some subset of pass-through businesses, and offer a corresponding tax credit to the owners of the business on their personal income taxes. The State continues to engage with stakeholders and other experts to determine the appropriate design of this proposal. An unincorporated business tax will provide the significant benefit of preserving deductibility for individuals on certain non-wage income while maintaining revenue levels for the State.