THE CITY OF NEW YORK
INDEPENDENT BUDGET OFFICE
110 WILLIAM STREET, 14TH FLOOR
NEW YORK, NEW YORK 10038
(212) 442-0632 • FAX (212) 442-0350 •EMAIL: iboenews@ibo.nyc.ny.us

Testimony of George Sweeting
Deputy Director, New York City Independent Budget Office
To the New York City Council Committee on Finance
On the Commercial Rent Tax

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Good afternoon Chair Ferreras-Copeland and members of the committee. Thank you for the opportunity to testify regarding this package of Intros that would make changes in the city's commercial rent tax (CRT). Before speaking about the particulars of the legislation I would like to offer some broader observations regarding the CRT.

The city's CRT is subject to a number of criticisms. First, it is virtually unique. Other than the state of Florida, which charges a sales tax of 6 percent on commercial rents, I know of no other large jurisdiction that taxes rents. Imposing such an unusual tax reinforces the notion that New York is a high tax location and may weaken efforts to attract and retain businesses. The CRT also pyramids one tax upon another. Some part of the rent charged by landlords to tenants reflects the owner's expenses—expenses that include property tax. Moreover, commercial leases in the city commonly include a tax escalation clause that explicitly passes on some or all of annual increases in property taxes to the tenants. With a portion of the landlord's property tax included in the rent, the CRT is in part a tax on the property tax. Such pyramiding is considered undesirable from a best practice perspective. Another critique is that the CRT treats otherwise similar businesses differently depending on whether they own their building or where they are located in the city.

While it is easy to find flaws with the CRT, there are things to bear in mind if contemplating its full repeal. First, the city expects to generate $816 million in CRT revenue this year and $848 million next year, or about 1.5 percent of all tax revenue. Those amounts are roughly equal to city-funded expenditures at the Department of Homeless Services and larger than the city-funded spending at agencies such as the Departments of Health and Mental Hygiene, Transportation, and Parks and Recreation. If the tax revenue were not replaced by raising other taxes, significant cuts in city-funded services would be needed to keep the budget in balance. Nor is it likely—given the relatively inelastic supply of commercial space and relatively low commercial vacancy rates for Manhattan—that eliminating the CRT would generate substantial new economic activity and associated tax revenue. With personal and business income tax rates in the range of 4 percent to 6 percent, the tax cut would need to add about 1.5 percent to total output in the city to be revenue neutral. None of this is to say the city should not consider major reductions in the CRT, but rather that it should be done with realistic understanding of the changes on the revenue and/or spending sides of the budget that would likely be necessary.

Moreover, it is unlikely that the tenant businesses would enjoy the full benefit of any tax cut. Although the legal liability of the tax falls on the tenants, some of the economic effect of the tax falls on landlords who are forced to accept somewhat lower rent to attract tenants to buildings subject to the tax. Exactly how much of the economic effect of the tax is shifted from tenants to landlords depends on market conditions when leases are signed, but it is reasonable to assume that landlords would be able to extract at least some of the benefits of tax reduction through higher rents if the CRT were eliminated or reduced.

Turning now to the legislation before the committee today. Intro 799-a would extend the current rent exemption from $250,000 to $500,000 and provide a sliding scale credit for those taxpayers with rent between $500,000 and $550,000 to avoid a sharp cliff in the tax liability above the exempt amount. The current exemption amount has been in place since 2001 with no adjustment for inflation in the interim. However, the doubling of the exemption amount exceeds the 44 percent change in the consumer price index, or CPI, and the 27 percent change in office rents in the intervening years.

Based on data supplied by the Department of Finance, IBO estimates that approximately 3,540 firms that currently pay a total of $47 million in CRT would be eliminated from the tax, with an average savings of about $13,250. Another 475 would have their CRT liability reduced by about $4.8 million or $10,100 on average. Given the relatively low rents paid by these tenants, it is likely that many are small firms renting relatively small spaces. These results are consistent with a goal of reducing the tax burden on smaller businesses. If implemented, Intro 799-a would likely leave the CRT tax base even more dependent on a relatively small number of large firms. For the 2016 tax year, over 51 percent of the liability ($388 million) came from just 368 taxpayers (4.8 percent).

Turning to Intro 1376, I would first like to complement the Department of Finance for taking steps in recent years to make basic distributional information about the CRT available on the department's website. The Intro would go further by calling for two-way tables such as the distribution of taxpayers and liability by base rent range, industry and location. This additional information would be useful for analysts and others trying to learn about who is paying the tax and how the burden is distributed. Based on IBO's recent experience working with the CRT data we currently receive from the finance department, there may be challenges in using the data to identify the location of CRT payers as called for in the Intro, particularly those with multiple premises. Likewise, we encountered difficulties with the industry coding, which makes it problematic to assess the effects of the other two Intros being considered today.

Thank you again for the opportunity to testify. I would be happy to answer any questions you may have.