

## Add a Property Tax Surcharge on Vacant Residential Property

Revenue: \$46 million annually

Over the last 10 years, concerns over the scarcity of housing have led city and state policymakers to propose a variety of additional taxes on housing not serving as owner-occupied primary residences, including a recently proposed pied-à-terre surcharge on nonprimary residences selling for \$5 million or more as well as a surcharge on one-, two-, and three-family homes (Class 1 properties) where the owner does not use it as a primary residence.

Another option would be for the city to levy an annual property tax surcharge on vacant residences regardless of the property's value, its use as rental property, or the owner's residency status. The surcharge, which would require state approval, would be added to the property's tax rate and prorated monthly for residences unoccupied for less than the full year. Policymakers could adjust the surcharge to exempt residences that are vacant for specific reasons such as those pending demolition.

Based on data from the 2017 Housing and Vacancy Survey, IBO estimates that 8.1 percent of the city's 3.5 million residential units would be subject to such a tax. If the city imposed an annual 5.0 percentage point surcharge on each of these properties, IBO estimates the tax would raise about \$46 million, or roughly \$163 per vacant residence. (These estimates include the allowance for prorating the surcharge for properties that are vacant only part of the year.) About half of this would be paid by condominium and cooperative owners, a fourth by landlords of Class 2 rentals, and the balance by Class 1 property owners.

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**Proponents might argue** that tax on vacant residences could increase the availability of housing by providing an incentive to more quickly rent or sell and by discouraging property owners from keeping residences vacant. In addition, since much of surcharge revenue would be paid by owners of houses and coop or condo apartments that already have low taxable assessed values relative to their market values, at the proposed rate the tax would have little impact on residences' effective tax rates, thereby ensuring their tax burdens are kept low relative to nonresidential property.

**Opponents might argue** that the tax would add an undue burden on property owners. At current rates, with homes taking on average about five months to sell citywide, the additional tax would increase the average tax paid by a vacant Class 1 property by 3.5 percent and 1.5 percent for condominium and cooperative property owners. Moreover, for owners of rental properties, the tax would increase a building's operating cost, thereby reducing the incentive to build or maintain housing in neighborhoods where it takes longer to find buyers and renters. This option would be difficult and costly to administer since it would require the Department of Finance to keep track of vacant residential units each month.

## Eliminate Commercial Rent Tax Exemptions for Retail Tenants in Lower Manhattan

Revenue: \$9 million annually

The commercial rent tax (CRT) is imposed on tenants who lease commercial space in buildings south of 96th Street in Manhattan. The tax only applies to leases worth more than \$250,000 per year. Nonprofit organizations, government agencies, and many theatrical productions are exempt.

The State Legislature created two additional CRT exemptions in 2005 as part of a bill to stimulate commercial recovery in Lower Manhattan. The new exemptions apply to all retailers located south of City Hall between South Street and West Street, as well as all tenants in the new World Trade Center buildings and most of those in the new Fulton Transit Center. According to data from city planning's PLUTO database, this exemption area includes 3.5 million gross square feet of retail space. Now that several of the buildings at the World Trade Center and the Fulton Transit Center have largely been completed, there is additional retail space of almost 400,000 square feet in the area. This option, which would require state legislation, would repeal the CRT exemptions for retailers in Lower Manhattan.

The Mayor's Office of Management and Budget estimates that the Lower Manhattan retail CRT exemptions will cost the city approximately \$4 million in fiscal year 2019 and grow by about \$300,000 annually. This estimate does not include the new retail space coming on-line at the Fulton Center and at the World Trade Center, which will substantially increase the cost of the incentive. Assuming that the new space is rented for \$400 per square foot and that 10 percent of the space will be vacant or exempt, the Fulton Center and World Trade Center retail exemptions could cost the city an additional \$5 million per year, for a total cost of the Lower Manhattan exemption of about \$9 million.

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**Proponents might argue** that subsidizing retailers is an unwise use of taxpayer money given their history of creating low-wage jobs. They might also argue that the CRT exemptions disproportionately benefit large retailers and national chains because most small retailers in Lower Manhattan are already exempt from the tax. Finally, they might argue that incentives are not necessary to attract new retailers. The owners of Brookfield Place and Pier 17, for example, are redeveloping their retail spaces even though both sites fall outside of the CRT exemption zones. New retailers are also attracted to the neighborhood's affluent and growing residential population, as well as its improving office market and record levels of tourism.

**Opponents might argue** that the incentives are needed to help Lower Manhattan recover from the effects of both September 11th and Hurricane Sandy. They might also argue that the neighborhood is underserved by retail, and that additional incentives are needed to attract retailers that will support Lower Manhattan's transformation into a mixed-use community. They might also note that the savings from the CRT exemption help overcome the disadvantage of trying to lure shoppers in a neighborhood still burdened by large construction sites and street disruptions.

# Eliminate Special Tax Treatment on the Sale of Properties To Real Estate Investment Trusts

Revenue: \$11 million annually

This option would eliminate New York City's special real property transfer tax (RPTT) treatment of real estate investment trust (REIT) transfers. The city's residential and commercial RPTT tax rates range from 1.0 percent to 2.625 percent of the sales price, depending on the value and type of property, and New York State levies its own real estate transfer tax at 0.4 percent to 1.4 percent. Designed to lower the expense associated with transferring property to a REIT structure, state legislation enacted in 1994 provided (among other benefits) 50 percent reductions in both city and state RPTT rates during a two-year period for qualifying property transfers made in connection with the formation of REITs.

In 1996, legislation made the RPTT benefit for new REITs permanent and temporarily expanded the 50 percent rate reduction to cover some property transfers to already established REITs. State legislation has repeatedly extended the reduced RPTT rates for property transfers to already established REITs, most recently to August 2020. Ending RPTT rate reductions for all REITs would provide the city with an estimated \$11 million annually in additional revenue.

Eliminating the city's RPTT rate reduction for new REITs would require state legislation.

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**Proponents might argue** that REITs already receive a number of tax benefits from New York City, including deductibility of income that is distributed to shareholders and corporate income tax liability that is determined using only two of the four alternate tax bases that other firms are subject to: net income and a fixed minimum tax. The state also provides a 50 percent reduction in its own RPTT and an exemption from the capital gains tax for property transfers to REITs. Given these benefits, they might argue that the advantages from converting to a REIT would outweigh the cost even in the absence of the city's RPTT break. Proponents might also question why the city would want to promote the formation of REITs and create a preference for one form of property ownership over another.

**Opponents might argue** that the formation of a REIT, which is a change in structure rather than a change in ownership, should not be subject to the same level of transfer tax as the transfer of property from one owner to another. They might also argue that without the tax incentive, transferring ownership to a REIT structure is more costly and would reduce the number of REIT formations, thereby limiting real estate investment opportunities for smaller investors. Moreover, the revenue gain associated with making the RPTT rate whole would be partially negated—and may even result in a net loss in RPTT revenue—depending on the extent to which property transfers to REITs decrease in response to a doubling of the RPTT rate.

## Extend the Mortgage Recording Tax to Coops

Revenue: Over \$95 million annually

The mortgage recording tax (MRT) is levied on the amount of the mortgage used to finance the purchase of houses, condo apartments, and all commercial property. It is also levied when mortgages on such properties are refinanced. The city's residential MRT tax rate is 1.0 percent of the value of the mortgage if the amount of the loan is under \$500,000, and 1.125 percent for larger mortgages. In addition, mortgages recorded in New York City are subject to a state MRT, of which a portion, equal to 0.5 percent of the value of the mortgage, is deposited into the city's general fund. Currently, loans to finance the sales of coop apartments are not subject to either the city or state MRT, since such loans are not technically mortgages. Extending the MRT to coops was initially proposed in 1989 when the real property transfer tax was amended to cover coop apartment sales.

The change would require the State Legislature to broaden the definition of financing subject to the MRT to include not only traditional mortgages but also loans used to finance the purchase of shares in residential cooperatives. In January 2010, then-Governor Paterson proposed extending the state MRT to include coops, and Mayor Bloomberg subsequently included in his preliminary budget for 2011 the additional revenue that would have flowed into the city's general fund had the proposal been enacted; ultimately, it was not adopted. IBO estimates that extending the city MRT to coops would raise over \$95 million per year. If the state MRT were also extended to coops, the additional revenue to the city would be around 50 percent greater.

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**Proponents might argue** that this option serves the dual purpose of increasing revenue and ending the inequity that allows cooperative apartment buyers to avoid a tax that is imposed on transactions involving other types of real estate.

**Opponents might argue** that the proposal will increase costs to coop purchasers, driving down sales prices and ultimately reducing market values.

## Impose a City “Mansion Tax”

Revenue: Over \$237 million annually

Sales of real property in New York City are subject to a Real Property Transfer Tax (RPTT). The combined city and state tax rates for residential properties are 1.4 percent when the sales price is \$500,000 or less, and 1.825 percent when the price is above \$500,000 but less than \$1 million. Residential properties that sell for more than \$1 million are subject to an additional state tax of 1.0 percent (often referred to as a “mansion tax”), for a total tax rate of 2.825 percent. While technically the RPTT is paid by the seller, economic theory suggests that the burden of the tax will be shared (not necessarily equally) between buyers and sellers.

Under this option a city version of the mansion tax would be levied on residential properties selling for more than \$1.75 million. The tax would have two rates: 1.0 percent on the first \$5 million of the transaction, and 1.5 percent on any additional amount. This tax would be in addition to the existing city and state rates, and IBO estimates that the tax would generate \$237 million in annual city revenue. As proposed, the tax would apply to the entire value of the property. If the tax were applied only to the value over \$1.75 million (with a higher rate of 1.5 percent above \$5 million), IBO estimates that revenue from the tax would be around \$142 million.

This option, which would require state legislative approval, is based on a proposal that the de Blasio Administration presented as part of the 2016 executive budget, but the State Legislature did not act on it.

An alternative proposal that IBO has presented in past versions of its budget options would impose a 0.5 percent levy on all residential sales valued at \$5 million or more. IBO estimates that this change would provide the city with almost \$50 million annually in additional revenue.

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**Proponents might argue** that the tax would raise a considerable amount of revenue while affecting a relatively small number of buyers and sellers; for example, only 10 percent of residential sales in fiscal year 2017 would have been subject to the new tax. The burden of the tax would be shared by sellers and buyers. Many buyers of luxury residences in New York City do not pay the mortgage recording tax (MRT) because they make all-cash purchases, or because they obtain financing overseas, or because they purchase coops, which are not subject to the tax. Even with an increase in the RPTT for high-priced properties, these buyers would face a lower tax burden than purchasers of lower-priced residences who pay both RPTT and MRT.

**Opponents might argue** that luxury residential real estate is already subject to a high RPTT rate, 2.825 percent. The proposed additions would bring the total RPTT on residences sold for between \$1.75 million and \$5.0 million to 3.825 percent, and the total rate for sales over \$5 million to 4.325 percent. These rates are well above the 3.025 percent RPTT imposed on commercial sales over \$500,000. Opponents might also point out that taxes on economic activity reduce the level of that activity, meaning that the new tax would lead to fewer residential sales. This downward pressure on housing prices would come as recent changes to federal tax law take effect. Opponents might also note a market distortion under this proposal because the higher tax rate would apply to the entire value of the property. As soon as the sales price exceeded \$1.75 million, there would be a jump of \$17,500 in RPTT liability. As a result of this cliff, we would expect a “bunching” of sales at or just below \$1.75 million.

## Limit J-51 Benefits to Projects With An Affordable Housing Component

Revenue: \$1 million annually

The J-51 program encourages the rehabilitation of residential buildings by providing the owner with both a property tax exemption and an abatement for approved improvements. Property owners receive the exemption on the increase in assessed value due to the improvement while the abatement partially refunds property owners for the cost of the improvement. Exemption periods can be either 34 years or 14 years—the former applies if the project also receives government support through an affordable housing program. In both instances, the exemption phases out in the final four years of the benefit period. Generally speaking, projects receiving government assistance can have up to 150 percent of the rehabilitation costs abated compared with 90 percent for all other projects. The total amount abated is spread over a 20-year period regardless of project type. In exchange for the benefit, apartments in rental properties become rent stabilized or remain rent stabilized while the building is receiving J-51 benefits.

In 2019, the program will cost the city \$292.8 million in forgone revenue—\$74.8 million from the abatement and \$218.0 million from the exemption. Roughly 90 percent of the aggregate benefit is distributed evenly between Manhattan, the Bronx, and Brooklyn. Rental properties citywide will receive two-thirds of the total J-51 benefits in 2019. About \$100 million is for projects with no affordable housing residential units.

This option, which would require Albany approval, proposes eliminating future J-51 benefits for new projects that do not have an affordable housing component. In effect, only projects receiving other government support under a program requiring low- or moderate-income housing would be eligible for new J-51 benefits. Were this proposal in effect in 2019, the city would raise an additional \$1.3 million in property tax revenue in 2019. This estimate is considerably lower than previous estimates because legislation passed in 2013 eliminated J-51 eligibility for many higher value coops and condos, which typically do not have affordable housing units.

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**Proponents might argue** that awarding J-51 benefits without requiring an affordable housing component is an inefficient use of public funds. In addition, the city no longer needs to incentivize residential rehabilitation for higher-income tenants because the current tight housing market provides a sufficient incentive by itself. Also, the program is not responsible for adding much to the city's stock of rent-stabilized housing. Many residential units that receive J-51 benefits are already rent stabilized because they were built before 1974 and have yet to be deregulated. The additional revenue could be reinvested into more worthwhile affordable housing programs.

**Opponents might argue** that J-51 is responsible for higher quality residences in areas of the city that would otherwise be dilapidated, having been ignored by the housing market. In addition, the J-51 program serves families that make too much money to qualify for affordable housing but not enough to live comfortably in market-rate housing. Thus, eliminating the 14-year program would also eliminate housing options for middle-income families.

## Make Real Estate Sales Between Nonprofits and For-Profits Subject to the City's Property Transfer Tax

Revenue: \$36 million annually

This option would modify the city tax treatment of real property transfers between nonprofit and for-profit entities, making them conform to state tax practice. Both New York City and the Metropolitan Transportation Authority (MTA) would receive new revenue from this change.

Property sales in New York City are subject to both a city and state real property transfer tax (RPTT). There are some exceptions, including transfers between two nonprofit entities, which are exempt from both city and state RPTT. Currently, transfers of real property between not-for-profit and for-profit entities are subject to the state RPTT, but not the city RPTT. The RPTT is normally paid by the seller, but in the case of a nonprofit entity selling to a for-profit concern, the buyer pays the (state) tax.

The city's RPTT rates range from 1.0 percent to 2.625 percent, depending on the property's value and type. Included in the highest rate is a 1.0 percent "urban tax" that is dedicated to the MTA. Based on sales data for fiscal year 2018, IBO estimates that eliminating the exemption in the city RPTT for nonprofit transfers to or from for-profit entities would raise about \$36 million annually for the city, and an additional \$24 million in urban tax revenue dedicated to the MTA. This change would require state legislation.

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**Proponents might argue** that for-profit entities that sell real property should not receive a tax break solely by virtue of the type of buyer. Conversely, if the not-for-profit entity is the seller, it will continue to be exempt from the tax, which would instead be paid by the for-profit buyer. In addition, proponents might argue that conforming city taxation to state practice increases the transparency of the tax system.

**Opponents might argue** that while the proposed tax would formally be paid by the for-profit entity, economic theory posits that buyer and seller would each bear part of the burden. As a result, the proposed extension of the city RPTT would increase the costs incurred by nonprofits, thereby diminishing their ability to provide the services that are their mission.



## Raise the Cap on Property Tax Assessment Increases

Revenue: \$156 million in first year and at least \$500 million in fifth year

Under current law, property tax assessments for Class 1 properties (one-, two-, and three-family homes) may not increase by more than 6 percent per year or 20 percent over five years. For apartment buildings with 4 units to 10 units, assessment increases are limited to 8 percent in one year and 30 percent over five years. This option would raise the annual assessment caps to 8 percent and 30 percent for five years for Class 1 properties and to 10 percent annually and 40 percent over five years for small apartment buildings. State legislation would be needed to implement the higher caps and to adjust the property tax class shares to allow the city to recognize the higher revenues.

This change would bring in \$156 million in the first fiscal year and \$500 million to \$633 million annually by the fifth year. These revenue estimates are highly sensitive to assumptions about changes in market values. The average property tax increase in the first year for Class 1 properties would be about \$177. With the assessment roll for fiscal year 2019 nearly complete, 2020 is the first year the option could be in effect.

The assessment caps for Class 1 were established in the 1981 legislation creating the city's current property tax system (S7000a) and first took effect for fiscal year 1983. The limits on small apartment buildings in Class 2 (which includes all multifamily buildings) were added several years later. The caps are one of a number of features in the city's property tax system that keeps the tax burden on Class 1 properties low in order to promote home ownership. Assessment caps are one way to provide protection from rapid increases in taxes driven by appreciation in the overall property market that may outstrip the ability of individual owners to pay, particularly those who are retired or on fixed incomes.

Although effective at protecting Class 1 property owners, assessment caps nevertheless cause other problems. They can exacerbate existing inequities within the capped classes if market values in some neighborhoods are growing faster than the cap while values in other neighborhoods are growing slower than the cap. Moreover, in a classified tax system, such as New York's, if only one type of property benefits from a cap, interclass differences in tax burdens will also grow. Beyond these equity concerns, caps can constrain revenue growth if market values are growing at a rate above the cap, particularly if the caps are set lower than needed to provide the desired protection for homeowners' ability to pay.

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**Proponents might argue** that an increase in the caps would eventually yield significant new revenue for the city. Further, by allowing the assessments on more properties to grow proportionately with their market values, intra-class inequities would be lessened. Finally, by allowing the overall level of assessment in Class 1 and in part of Class 2 to grow faster, the interclass inequities in the city's property tax system would be reduced.

**Opponents might argue** that increasing the burden on homeowners would undermine the city's goals of encouraging home ownership and discouraging the flight of middle-class taxpayers to the suburbs. Other opponents could argue that given the equity and revenue shortcomings of assessment caps they should be eliminated entirely rather than merely raised.



## Tax Vacant Residential Land the Same as Commercial Property

Revenue: \$17 million in the first year, rising to \$115 million annually when fully phased in

Under New York State law, a residentially zoned vacant lot or a commercially zoned lot that is situated immediately adjacent to property with a residential structure, has the same owner as the adjacent residential property, and has an area of no more than 10,000 square feet is currently taxed as Class 1 residential property. All other vacant land is taxed as commercial property. In fiscal year 2019, there are 15,127 vacant properties not owned by government. As Class 1 property, these vacant lots are assessed at no more than 6 percent of full market value, with increases in assessed value due to appreciation capped at 6 percent per year and 20 percent over five years. In 2019, the median ratio of assessed value to full market value was 3.0 percent for these properties.

Under this option, which would require state approval, vacant lots not owned by a government entity with an area of 2,500 square feet or more would be taxed as Class 4, or commercial property, which is assessed at 45 percent of full market value and has no caps on annual assessment growth; 7,467 lots would be reclassified. Phasing in the assessment increase evenly over five years would generate \$17.0 million in additional property tax revenue in the first year, and the total increment would grow by \$25.0 million in each of the next four years. Assuming that tax rates remain at their 2019 levels, the total property tax revenue generated by the reclassification upon completion of the phase-in would be \$115.4 million.

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**Proponents might argue** that vacant property could be better utilized, and awarding it preferential treatment further encourages its underdevelopment. The intention of the lower assessment rate, they could argue, is to incentivize development of Class 1 property. Vacant land zoned for residential use that is not being developed for its intended purposes may thus be an unwise policy at a time in which the city is experiencing a shortage of affordable housing. Proponents might further note that the lot size restriction of 2,500 square feet (the median lot size for Class 1 properties with buildings on them in New York City) would not create incentives to develop very small lots, and the city's zoning laws and land use review process also provide a safeguard against inappropriate development in residential areas.

**Opponents might argue** that the current tax treatment of vacant land serves to preserve open space in residential areas in a city with far too little open space. Opponents might also argue that zoning policies are less effective at restricting development in residential areas than the preferential tax treatment because the latter is codified in real property tax law. Furthermore, opponents might also point out that the vacant lots have a median land area of 4,000 square feet while the median area of existing Class 1A, 1C, and Class 2 property with at least 2,500 square feet is 10,200 square feet. Thus, many of the vacant residential lots would be too small to develop for housing and would sit vacant even if reclassified.