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**OPTION:****Add a Property Tax Surcharge on Vacant Residential Property**

Revenue: \$29 million in the first year

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 a 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 requires 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 2014 Housing and Vacancy Survey, IBO estimates that 5.2 percent of the city's 3.2 million residences 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 \$29 million, or roughly \$175 per vacant residence. (These estimates include an allowance for prorating the surcharge for properties that are vacant only part of the year.) About half of this would be paid by landlords of Class 2 rentals, a third by other Class 2 apartment owners, and the balance by Class 1 property owners.

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**PROPOSERS MIGHT ARGUE** that a 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 it is levied against residential properties' already low taxable assessed value, 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.

**OPPOSERS MIGHT ARGUE** that the tax would add an undue burden on property owners. At current rates, with homes taking on average about eight months to sell citywide, the additional tax would increase a vacant Class 1 property's statutory tax rate by 17 percent and a Class 2 residence's rate by almost 26 percent. 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 difficult to sell neighborhoods where it takes longer to find buyers and renters.

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**OPTION:**

## Create a New Real Property Transfer Tax Bracket for High-Value Residential Properties

Revenue: Over \$50 million annually

The real property transfer tax (RPTT) is levied on the sale of real property. The city's residential RPTT rate is 1.0 percent on transactions valued at \$500,000 or less, and 1.425 percent on transactions valued at over \$500,000. In addition, there is a New York State RPTT of 0.4 percent on residential sales under \$1 million, and 1.4 percent on sales valued at \$1 million or more. Residential sales involving a mortgage are also subject to combined city and state mortgage recording taxes of 2.050 percent on the value of mortgages under \$500,000, and 2.175 percent on mortgages of \$500,000 or more.

This proposal, which would require state legislative approval, would add another bracket to the city RPTT on residential properties. Under the proposal, sales of residential properties valued at \$5 million or more would be subject to an additional 0.5 percent levy. IBO estimates that the city would have gained \$54 million in revenue if this tax increase was implemented at the start of 2017 and would increase gradually in subsequent years.

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**PROPOSERS MIGHT ARGUE** that this option complements the state's higher rate on residential sales of \$1 million or more. Economic distortions should be less than in the case of the state tax, however, due to the smaller increase and higher threshold for the city tax. They might also note that many sales in the over \$5 million market do not involve mortgage financing and hence generate no mortgage tax, so that even with the higher RPTT rate the combined transfer tax burden is lower than for sales of less expensive properties that typically use conventional financing. The tax also has a low cost of administration and is difficult to avoid, which makes it an efficient means for the city to raise revenue.

**OPPONENTS MIGHT ARGUE** that in New York City, buyers and sellers of residential property in the price range of \$5 million and above already face a high tax burden. Currently, the combined city and state RPTT on residential transactions valued at \$1 million and above is 2.825 percent. While the RPTT is nominally paid by the seller, economic theory suggests that the burden of the tax will ultimately be shared between buyers and sellers. They might also note evidence that some purchasers will find ways to avoid paying the new, higher rate. Finance department data show a concentration of residential sales just below the \$1 million mark, which is likely the result of a strategy to avoid the higher state RPTT on sales of \$1 million and above. A similar concentration just under \$5 million might emerge if this option were adopted.

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**OPTION:**

## 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 2018 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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**PROPOSERS 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.

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**OPTION:****Eliminate the Discount for Paying Property Taxes Early**

Revenue: \$9 million annually

Since the 1970s the city has offered property owners a discount on their property taxes if they remitted their outstanding liability early. At the time the discount was adopted the city was enduring a fiscal crisis and facing the prospect of having insufficient cash to meet its immediate financial obligations. The discount was created as a cash management tool allowing the city to raise cash quickly by incentivizing early payment.

Each year the Banking Commission recommends to the City Council what discount percentage would be most fiscally prudent given the city's current and expected cash position. If the City Council does not act on the Banking Commission's recommendation, the default discount rate is 1.5 percent as stipulated in the City Charter. For 2016, the Council adopted a 0.5 percent discount rate. Property owners that pay the year's liability by July 1 will receive the full 0.5 percent discount, a 0.33 percent discount if the year's balance is paid by October 1 (for quarterly payers), or a 0.25 percent discount if the year's balance is paid by January 1.

From 2011 through 2015, the city rebated \$180.3 million to 1.8 million property owners for an average tax savings of \$103. During this period, residential property owners (Class 1 and Class 2) saved \$40.7 million while nonresidential property owners (Class 3 and Class 4) saved \$139.8 million.

Under this proposal, the city would eliminate the early payment discount, which can be accomplished in one of two ways: removing the provision from the City Charter or reducing the discount rate to zero percent. The latter would require an annual City Council resolution because the City Charter prescribes a discount rate of 1.5 percent if the Council does not act. If the discount had been eliminated for 2016, the net effect on city revenue would have been \$9.3 million, assuming no taxpayer would have made early payments without the discount incentive. The city would have taken in an additional \$11.2 million in property tax revenue on the portion of property tax liability paid early, but it also would have forgone \$1.9 million in accrued interest income that would have been earned had the city received the early payments. Unlike most other features of the city's property tax system, eliminating the discount would not require approval from the state Legislature; it can be done through local law.

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**PROPOSERS MIGHT ARGUE** that the policy rationale for the discount no longer applies. The discount was adopted when the city faced cash shortages, but since the late 1970s the city has been required to end each year with a balanced budget according to generally accepted accounting principles and to publish quarterly budget updates that help reduce the risk of unanticipated budget shortfalls. These and other financial management controls adopted after the 1970s fiscal crisis have been sufficient to avert short-term cash flow problems, and therefore the discount is unnecessary.

**OPPOSERS MIGHT ARGUE** that the discount is an important tool to have available in case of a cash shortfall. If cash was immediately needed, the discount could also take too long to restore if it were eliminated. In addition, the discount provides some tax relief for businesses, which carry a disproportionate share of the city's property tax burden.

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**OPTION:****Eliminate J-51 Benefits for Projects That Do Not Include an Affordable Housing Component**

Revenue: \$5 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.

In 2016, the program will cost the city \$265.5 million in forgone revenue—\$84.9 million from the abatement and \$180.6 million from the exemption. Roughly 90 percent of the aggregate benefit is distributed evenly between Manhattan, the Bronx, and Brooklyn. Benefits to property owners in Queens and Staten Island comprise 9.2% and 1.1% of the citywide total, respectively. Citywide, rental properties receive two-thirds of the total J-51 benefit awarded in 2016.

This option, which would require Albany approval, proposes eliminating future J-51 benefits for 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 J-51. Were this proposal in effect in 2016, the city would have raised an additional \$4.7 million in property tax revenue in 2016.

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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 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.

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**OPTION:****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 2017. Ending RPTT rate reductions for all REITs would provide the city with an estimated \$2 million annually in additional revenue.

Eliminating the city's RPTT rate reduction for new REITs would require state legislation. Eliminating reduced RPTT rates for already established REITs could be effected either by state legislation or by allowing the tax break to simply expire in August 2017.

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**PROPOSERS 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.

**OPPOSERS MIGHT ARGUE** that 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.

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**OPTION:****Extend the Mortgage Recording Tax to Coops**

Revenue: Over \$80 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 \$86 million in 2018. 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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**PROPOSERS 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.

**OPPOSERS MIGHT ARGUE** that the proposal will increase costs to coop purchasers, driving down sales prices and ultimately reducing market values.

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**OPTION:****Make Real Estate Sales Between Nonprofits & For-Profits Subject to the City's Property Transfer Tax**

Revenue: \$10 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 years 2011-2014, IBO estimates that eliminating the exemption in the city RPTT for nonprofit transfers to or from for-profit entities would raise about \$19 million annually for the city, and an additional \$11 million in urban tax revenue dedicated to the MTA. This change would require state legislation.

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**PROPOSERS MIGHT ARGUE** 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.

**OPTION:****Raise the Cap on Property Tax Assessment Increases**

Revenue: \$136 million in the first year and at least \$360 million by the 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 about \$136 million in the first fiscal year the option could be in effect and \$360 million to \$539 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 \$143.

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.

**PROPOSERS 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, intraclass 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.

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**OPTION:**

## Tax Vacant Residential Property the Same as Commercial Property

Revenue: \$21 million in the first year, rising to \$125 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 2016, there are 16,123 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 2016, the median ratio of assessed value to full market value was 2.7 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; 8,120 lots would be reclassified. Phasing in the assessment increase evenly over five years would generate \$20.5 million in additional property tax revenue in the first year, and the total increment would grow by \$26.5 million in each of the next four years. Assuming that tax rates remain at their 2015 levels, the annual property tax revenue generated by the reclassification once the phase-in is complete would be \$125.1 million.

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**PROPOSERS MIGHT ARGUE** that vacant property could be better utilized, and awarding it preferential treatment further encourages its underdevelopment. An important justification for the lower assessment rate for Class 1, they could argue, is to incentivize development of one-, two-, and three-family homes. Reducing the cost of holding vacant land zoned for residential use at a time in which the city is experiencing a shortage of affordable housing is unwise. 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.

**OPPOSERS MIGHT ARGUE** that the current tax treatment of this 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 8,120 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 are too small to be developed for the multifamily housing that is most needed to address the city's affordable housing needs.