Forecasting Challenges in Light of Tax Policy Changes

Presented to the 2019 FTA Revenue Estimation and Tax Research Conference
September 24, 2019

Joshua Goldstein,
Assistant Director Tax Policy Revenue Forecasting & Economic Analysis
New York City Office of Management & Budget
Forecasting Challenges in Light of the Tax Cuts and Jobs act.

- Interpreting the law
- Addressing the State and Local tax policy legislative issues, conformity, and work around.
  - Determining short-term intertemporal behavior compared to long-term structural changes.
  - Incorporating new information into existing econometric models
<table>
<thead>
<tr>
<th>Intertemporal</th>
<th>Structural</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Typically one time in nature</td>
<td>• Permanent</td>
</tr>
<tr>
<td>• Behavioral</td>
<td>• Economic</td>
</tr>
<tr>
<td>• Shifting income/liability from one period to another to minimize tax liability</td>
<td>• Example: Capping SALT makes high tax (income and property) jurisdictions less competitive.</td>
</tr>
<tr>
<td>• Example: In order to take advantage of uncapped State &amp; Local Tax (SALT) deductions, individuals maximized State and Local tax liability at the end of 2017.</td>
<td>– Less State &amp; Local income liability</td>
</tr>
</tbody>
</table>
Challenges
Introduced by Intertemporal Shifting
Challenge: Intertemporal shifting complicates forecasting.

NYC INSTALLMENT/ESTIMATED PAYMENTS

$ MILLIONS

FY 15
FY 16
FY 17
FY 18
FY 19

September  December  January  April

Election
TCJA
Challenge: Determining one-time behavior

NYC INSTALLMENT/ESTIMATED PAYMENTS

- FY 15: $3,167
- FY 16: $3,021
- FY 17: $2,633
- FY 18: $3,717
- FY 19E: $3,129
Challenge:
Forecasting bonus payments subject to a one time exogenous shock

April 2018
Structural Challenges

How does the SALT CAP impact NYC’s long run income tax forecast?
**Challenge:** Who is impacted by the cap on SALT deductions?

NYC has a relatively high State & Local income tax burden.

<table>
<thead>
<tr>
<th>State</th>
<th>Top Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>13.3%</td>
</tr>
<tr>
<td>NYC &amp; NYS</td>
<td>12.696%</td>
</tr>
<tr>
<td>Hawaii</td>
<td>11.0%</td>
</tr>
<tr>
<td>New Jersey</td>
<td>10.75%</td>
</tr>
<tr>
<td>Oregon</td>
<td>9.90%</td>
</tr>
<tr>
<td>Minnesota</td>
<td>9.85%</td>
</tr>
</tbody>
</table>

- NYC residents took $34 billion in State & Local tax deductions in 2016. (SOI)
**Challenge:** High income “millionaires” filers face the greatest impact from the SALT deduction cap. However, NYC residents were already facing higher income tax burdens than low tax/no tax locales.

Filer with $1m in Taxable Income Before SALT deduction

<table>
<thead>
<tr>
<th>Location</th>
<th>Federal Income Tax</th>
<th>NYS Income Tax</th>
<th>NYC Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NYC Before TCJA</strong></td>
<td>$332,191</td>
<td>$88,200</td>
<td>$38,635</td>
</tr>
<tr>
<td><strong>Florida Before TCJA</strong></td>
<td>$351,819</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>NYC After TCJA</strong></td>
<td>$331,990</td>
<td>$88,200</td>
<td>$38,635</td>
</tr>
<tr>
<td><strong>Florida After TCJA</strong></td>
<td>$335,690</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

New York City millionaires paid $107,207 more in income taxes before TCJA

New York City millionaires paid $123,135 more in income taxes after TCJA
Challenge:

Historical evidence, NYC “millionaires” and NYS top tax rate
**Challenge:** NYC has about 30k filers with AGI > $1m. They account for over 1/3 of the AGI. Their income has always been volatile.
Summary of Challenges

1. Determine what is intertemporal and what is structural

2. Control for the intertemporal behavior
   - Forecast based on economic fundamentals, might help explain magnitude of one time nature.
   - Incorporate dummy variables to avoid future bias

3. Address structural changes
   - Determine who is impacted by policy change
   - Determine impact of policy change
   - If possible, incorporate information into models: add national/local tax rates into equations.
   - Careful not to double count the impact if independent variables already show behavior.
Other questions

• Does the SALT CAP make NYC relatively less competitive, reducing income recognized in NYC?

• Does the SALT CAP reduce demand for housing resulting in lower prices, fewer transactions, and ultimately lower property taxes.

• Do lower corporate tax rates increase capital gains (buy backs) or dividend payments?

• Do C-corps convert to pass-throughs or do pass-throughs convert to C-Corps?

• Does the introduction of Opportunity Zones impact capital gains?
  – Deferral might reduce short-term capital gains, but might not differ from section 1031
  – Step-up basis might reduce long term capital gains income.