

Reasoning with the Taxman

Government can't tax New York to prosperity; a plea for fiscal sanity

BY ROBERT KNAKAL

I love New York City. New Yorkers are tough, resilient, irrepressible, imaginative, inventive and, for the most part, optimistic. New Yorkers have a spirit that is difficult to suppress. From what I have read lately, it seems America may need a dose of this spirit, given the present thoughts that are seeping into the nation's collective psyche.

Last week, we were told that our gross domestic product grew by 3.5 percent in the third quarter of 2009. Few people were encouraged by these numbers because people don't have a great deal of faith in them. It is quite clear that more than two-thirds of this increase consisted of activity from government programs and government spending. Few believe the economy is currently strong enough to grow independently of massive government support.

At the moment, the United States has several concerns, including unprecedented government spending, massive deficits, foreign ownership of our debt, world terrorism, two wars, potential flu epidemics and who does or does not have nuclear weapons. But these are not our biggest threats: According to a new business survey, our biggest long-term threat is that people are increasingly becoming disheartened. They are concerned that our economic condition is reaching a critical point that is afflicting, most broadly and deeply, those members of the American leadership class who are not in Washington but are at the helm of businesses across the country. Over 90 percent of businesspeople believe their taxes will go up substantially in the near term. This includes federal, state and local taxes. They also believe they will be worse off in 2010 than they were in 2009.

Many Americans, including those who have experience on the ground in how the country works, cannot figure a way out of our current predicament. This is something new in our political history, and many are not acknowledging that, increasingly, Americans are starting to think the problems we are facing cannot be solved.

Part of the reason for this is the

immense magnitude of the spending and debt. There are no clear solutions or strategies to conclude the wars we are participating in. But more importantly, our government, from the White House through Congress and most state and local governments, is demonstrating that it's having trouble finding solutions. Our leaders are simply not offering inventive new paths, only continuing old paths of spending more, regulating more and taxing more. In the long term, few people in the business world believe this is a winning formula.



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Relentless spending is something that politicians cannot seem to avoid, and New York has suffered because of it. Our new state budget shows a projected deficit of \$17.7 billion, and that estimate did not take into account the greatly reduced revenue that is currently anticipated. Budget gaps get closed by cutting spending, increasing taxes or a combination of both. The path of least resistance for politicians is to raise taxes, particularly on the most productive taxpayers, who represent the smallest percentage of the voter base.

To meet the projected deficit, New York is cutting spending to make up 20 percent of the gap; the other 80 percent will be filled via 137 new or increased taxes, fees and charges. Most of this will come from increases on personal state income taxes for those earning more than \$200,000 (a 12.7 percent increase) and those earning more than \$500,000 (a 23.6 percent increase).

Our \$131.8 billion budget was increased by 10.1 percent, or \$12.1 billion, over last year. Politicians claim that the increase was due to the spending of stimulus money received from the federal government. Unfortunately, this is not accurate: Minus any stimulus money, the budget still increased by 4.7 percent, or \$5.9 billion. This is much higher than the rate of inflation and much higher than the increases in an overwhelming majority of individual and business budgets.

For years and years, we have

seen spending in our state accelerate and taxes increase. A familiar definition of insanity is to keep doing the same thing over and over and expecting a different result.

For as long as I can remember, real estate leaders in New York City have been concerned about the high level of taxes in the city out of fear that businesses and individuals would leave for a more tax-friendly location. After all, our real estate markets need people and businesses to want to live and to locate here. Many elected officials pooh-poohed this position, because, after all, "Where else would people want to live? Besides, businesses have to be in New

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Two weeks ago, this fear was made tangible, as a study was released by the Empire Center for New York State Policy that shows middle-class people are leaving the city in meaningful numbers. Given the extraordinarily heavy state and local tax structure, these results are not surprising.

The report shows that between 2000 and 2008, New York had a net domestic outflow of more than 1.5 million, which was the largest exodus from any state. Unfortu-

nately, most of those who left resided in New York City. These departures have significant budget consequences, as they tend to include residents who are much better off than those who are arriving. In 2006 alone, the blow to the state budget was \$4.3 billion in taxpayer revenue due to these trends. The impact from 2000 to 2008 resulted in lost revenue estimated at approximately \$30 billion.

The Empire Center study does not drill down to the reasons for this migration, but the assumption is that the notorious state and local tax burden faced by New Yorkers was the main reason. Going back to 1977, New York State has ranked first or second in the country for its state-local tax burden compared with all other locales in the U.S. An illustration of the effect of high taxes on migration is found in 2004. This was the year in which the tax burden for New Yorkers peaked; the following year saw a peak in departures, at more than 250,000. This year we are faced with an even higher peak in the tax burden. It will be interesting to see what happens to our population next year.

Proving that behavior is altered based upon such incentives, a recent tax case was won by a hedge fund titan who avoided \$27 million in city taxes after proving to New York's tax court that he spent more than half of his nights outside of the Big Apple. In the upside-down world of tax law, where citizens are guilty until they can prove their whereabouts, it's a rare taxpayer victory. The victory was won due to a meticulous assistant who kept a computer calendar so precisely that she even counted as a day in New York one evening when her boss crossed the George Washington Bridge at 11:45 p.m. and entered the city.

That a man who has so much would be willing to subject himself to such a trial, and put himself under such surveillance by his office staff, tells us something about the tax burdens that have become a fact of life in so much of America. New York City and surrounding locales would be served well if they tried harder to encourage people and businesses to locate here and devoted fewer resources punishing those who do.

Increased taxes hurt our real estate market. Higher taxes mean reduced consumer spending based upon reduced disposable incomes. Reduced consumer spending affects the retail sector, placing downward pressure on rents and resulting in increased vacancy. If people leave New York for a lower-cost alternative, we will experience lower home prices and residential rents. If businesses decide to relocate because of the local tax environment, it will cause office rents to drop and vacancies to rise. As budget deficits continue to grow, real estate taxes become a bigger target as a source of filling the gap. All of these issues affect the long-term health of our real estate market and our city.

When we see those in government, both locally and in Washington, consistently come up with new ways to tax and spend, it must make us think: Why aren't they worried about the impact of their actions? Do they really believe that we are completely immune to their effects? America is indeed the strongest nation in the world. Do they just take this for granted and believe that, no matter what they do, they cannot damage the country? There are ramifications for every decision and every action, whether they're felt in the short term or the long term.

In New York, we have emerged from every form of adversity—and there have been many, going all the way back to the 1600s—and we have done so bigger and stronger than before. I remain optimistic about the future of our great city and remain hopeful that those in power will embrace fiscal responsibility. This will take a long-term perspective and a willingness to do what is right, not necessarily what will be popular or what will enhance one's ability to get reelected.

Our challenges are many, and while they are difficult, they are not insurmountable. New York will ultimately thrive, but we will get there much sooner if legislated policy helps us to. It is incumbent upon each of us to do what we can to try to make a difference for our future and the future of New York.

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