Time for a Plan B for New York?

Recently, Congress is been discussing a tax reform plan that could have profound implications for the commercial real estate market, New York and the entire tri-state area.

There are many aspects of the reform that sound good, but what are the costs to get these benefits?

One of the benefits would be a reduction in corporate tax rates. If corporate taxes are reduced to the extent they have been proposed, profits should rise substantially allowing companies to invest and grow. This would lead to more jobs and the need for more office, retail and industrial space to be occupied by these companies, a good thing for commercial real estate.

Robert Knakal

Personal tax rates, for all but the highest earners, would go down as well. This would leave the average American with more disposable income, which could be invested or spent on goods and services.

These reductions in corporate and personal tax rates would necessitate tradeoffs. This means that several types of deductions would no longer be permitted. The deduction for state and local taxes (SALT) is a key deduction that appears to be on the chopping block. Importantly, for high-tax states, especially New York, this could be devastating.

With tax rate for the highest earners remaining essentially flat, eliminating the deduction for state and local taxes would effectively raise this group's tax burden by 6 to 8 percent. New York has the highest tax burden of any state in America. Here, we pay about 12.7 percent in state taxes (that's before the additional 4 percent tax paid by residents of New York City). If New York City residents moved to a zero-stateo-tax state like Florida, their tax burden would be reduced by 16.7 percent, a meaningful margin.

This tax increase could be enough to incentivize the highest earners among us to leave the state. I have already heard some high-income earners discussing this. And this is something I think could actually happen. It's not like the snowflakes in Hollywood who threatened to leave the United States if Donald Trump was elected president. To my knowledge, none have actually moved out of the country yet. However, many New Yorkers in the top tax bracket already have homes in Florida, or other lower tax states, who could decide it's time to move on. And New Jersey and Connecticut are not options as they have relatively high state taxes as well.

The tax burden in the United States is disproportionately skewed toward high-income earners. For instance, the top 20 percent of taxpayers pay 88 percent of federal taxes. Last year, this group paid approximately $1.2 trillion. The next 20 percent of taxpayers paid about $175 billion in total while the bottom 60 percent of taxpayers paid nothing. In fact, due to refundable tax credits, the bottom 60 percent received $17 billion back.

Additionally, the top 1 percent of taxpayers pays 38 percent of all federal taxes while earning 15 percent of all income.

While these are numbers for the nation, the disproportionality of the tax burden hits New York State even harder.

So what do elected officials do if SALT are no longer deductible? If they want to keep those in the state who earn the most, and consequently add the most to our state's revenue, action must be taken. There would likely be a significantly negative impact on tax revenue received. Many state politicians have indicated that there is no Plan B if this revenue goes away. Well, it's time for them to wake up.

Just as happens with any business, if you suspect you are going to have a hit to your revenues, you must cut expenses. But will state officials have the guts to slash spending? That is never easy, or pain free, but is often necessary. I read something last week that came from one of our top politicians in Albany stating all the "progress" that the state has made with regard to reducing the tax burden that New Yorkers face. That's like saying, if a student studies extra hard and gets a 46 percent on their test rather than the 42 she would have gotten without the extra work, she is making progress. Progress, yes, but the grade is still an F. We still have the highest tax burden in the nation. That's also an F.

Plan B will require some hard choices. Choices no one seems to want to think about for the moment. Let's hope they don't have to.

Robert Knakal is the chairman of New York investment sales for Cushman & Wakefield.