

TAX SECTION

New York State Bar Association

Letter on Itemized Deductions

January 18, 1991

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January 18, 1991

The Honorable Mario M. Cuomo
The Governor of New York
The Capitol
Albany, New York 12224

Dear Governor Cuomo:

I write to urge that your 1991 budget message recommend legislation to reverse a situation in which individual taxpayers' itemized deductions for computing New York State and City income tax will be reduced both by New York's own drastic limitations on such deductions and by Federal limits on such deductions enacted last year. New York taxpayers will in 1991 and later years be subject to the cumulative effects of these two sets of limitations unless legislative action is taken.

The 1990 Federal tax legislation (Title xi of the "Revenue Reconciliation Act of 1990") added Section 68 to the Internal Revenue Code. This provision, which our Congressional delegation and other representatives strongly opposed, reduces allowable itemized deductions for years 1991-1995 by three percent of the excess of adjusted gross income over \$100,000 for individuals filing joint returns and over \$50,000 for other individuals.

Section 615(a) of the New York Tax Law allows a resident individual itemized deductions for State purposes equal to the "total amount of his deductions from federal adjusted gross

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income" with certain adjustments (including the add back of State and city income tax deductions), and subject to disallowance under Section 615(f) of up to 50 percent of State itemized deductions otherwise allowed. Thus, as the Tax Law now stands, beginning in 1991, State itemized deductions will be reduced first under Federal section 68, and the balance will be further reduced by up to 50 percent under Section 615(f). Note that the Federal reduction could represent a very large percentage of a taxpayer's total itemized deductions, since the disallowance is three percent of adjusted gross income not three percent of itemized deductions. The State and Federal reductions together could eliminate a very high percentage of itemized deductions.

A comparable problem exists under the New York City individual income tax.

Section 68 was acknowledged by its sponsor, Congressman Pease, to be a device for effecting a disguised tax rate increase. If Congress had increased individual income tax rates in a straightforward way, New York State and City would clearly not have conformed to that change. Although the State and City tax systems do and should conform to the Federal system for purposes of measuring income, the State and City should set their own tax rates. A disguised New York State and City rate increase should not take place simply because of the convoluted mechanism chosen by the Federal government to increase its own tax rates. This is particularly so since New York State and New York City have already chosen to, in effect, increase tax rates for high income taxpayers by disallowing a percentage of itemized deductions. The choice as to the aggregate reductions (if any) that are warranted to increase State or City revenues rather than to more accurately measure income should not be made by the Federal government.*

It is particularly important to sever this link between State, City and Federal rate structures given the possibility that there may be efforts in Congress to effect future Federal rate increases by increasing the portion of itemized deductions disallowed by Section 68. The State will have a difficult time arguing effectively against such future increases if it has been taking advantage of Section 68 to collected additional State and City tax revenues.

* We in general believe that the New York State and City reductions of allowable itemized deductions by up to 50 percent is unsound as a policy matter, particularly as it limits deductions for investment interest and similar itemized expenses relating to the production of income. However, we recognize the difficulty of correcting this element of the Tax Law and the Administrative Code in the present budgetary atmosphere. Nonetheless, we should not allow a bad situation to be made worse by allowing Section 68 to further reduce deductions allowable for New York purposes.

For the foregoing reasons, we recommend that Section 615 be amended to provide that State itemized deductions shall equal the deductions from Federal adjusted gross income determined without regard to Section 68 of the Code, with the other adjustments now provided in the Tax Law.

A parallel amendment should be made to the comparable provision of the New York City Administrative Code.

If our recommendation to disregard the Section 68 adjustment in determining State itemized deductions is not accepted, then the State should in any event make clear that New York's 100 percent disallowance of income taxes (and certain other allowable Federal itemized deductions) as New York deductions is limited to the amounts of such taxes (and other items) included in Federal itemized deductions after pro-rata reduction of each Federal itemized deduction to the extent necessary to comply with Section 68 of the Code. We believe such action is correct under present law and requires only changes in New York State income tax forms and instructions.

Again, parallel action should also be taken administratively by New York City.

We would note, however, that this method of adjusting for the effects of Section 68 will further complicate the calculation of tax by affected taxpayers. This is a further reason for our basic recommendation that New York should ignore Section 68 in determining State and City itemized deductions.

We would, of course, be willing to discuss this issue further with you or your staff and assist in the drafting of corrective legislation.

Yours very truly,

Arthur A. Feder
Chair

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