New York City Independent Budget Office Fiscal Brief

December 2012

Federal Tax Cut Deadline:

What Washington's Decisions Could Mean For New York City's Taxpayers

Summary

As the clock ticks down in Washington on the debate over what to do about the impending expiration of numerous tax changes on December 31, 2012, IBO has modeled five scenarios and how each would alter the amount of federal income taxes paid by New Yorkers in 2013. For each of the five possible outcomes considered, IBO estimates how much in income taxes would flow from the city to the federal treasury as well as how the amounts owed by New Yorkers at various income levels are affected. Among our findings:

- Under a scenario in which all the tax cuts are renewed, which serves as our benchmark, New York would send an estimated $49.6 billion in federal income tax to Washington in 2013. The average New Yorker would have a tax bill of $14,026. The nearly one-third of city tax filers with incomes from $0 to $20,000 would receive an average of $1,235 back from the federal tax system because the amount of refundable tax credits they are eligible for exceeds the amount of taxes they owe. The 12,300 filers with incomes between $1.0 million and $2.0 million would pay an average of $395,218.
- If all the tax cuts expired, the city would send an estimated $9.5 billion more to Washington than if the cuts were renewed. Not just higher income New Yorkers would be affected. The average income tax paid by filers with incomes ranging from $20,000 to $50,000 would be three times higher than if the cuts had been renewed, increasing from almost $583 to $1,685.
- If the tax cuts were only extended for filers with incomes under $250,000—similar to the plan introduced by President Obama in his most recent federal budget proposal—the city would send $3.8 billion more income tax to Washington in 2013. While this scenario would only affect the highest income New Yorkers, their taxes would not rise on average as much as under a cap on deductions.
- If the tax cuts are renewed along with a cap of $50,000 on itemized deductions for high-income taxpayers, city residents would pay $5.3 billion more in income taxes to Washington in 2013 than if the changes were simply renewed. This scenario would hit the highest income New Yorkers hardest, beginning with incomes over $250,000 but especially at $2.0 million and above. More than a third of itemized deductions are taken by the roughly 9,700 resident filers with incomes over $2.0 million. These filers account for 63.0 percent of New Yorkers' charitable deductions.
- If the tax cuts are renewed but the current low rates on capital gains revert to their previous levels and dividends are again taxed as ordinary income, city residents would owe $1.9 billion more federal income tax. Filers with incomes above $250,000 would account for more than 90 percent of higher taxes under this scenario.

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Overview

On December 31, 2012 a multitude of income tax changes that were enacted in the years since 2001 are set to expire. The cuts had all been passed as temporary changes to underlying tax law. Thus, under current law the old rules and rates would come back into effect on January 1, 2013, significantly raising individual tax liabilities and contributing to the so-called fiscal cliff. Most of these tax cuts were enacted during the administration of President Bush though a few began during President Obama's administration. The income tax cuts that will expire, absent legislative action, affect tax brackets and marginal rates, preferential rates for capital gains and dividend income, deductions and personal exemptions, and tax credits.

Lawmakers in Washington are now deliberating whether to extend, alter, or let expire some or all of the cuts; the last option will happen by default if Congress takes no action. One important policy concern is how the various options for renewing, altering, or discontinuing tax cuts would affect the federal income tax liabilities of taxpayers at different income levels. The concern is of particular relevance in the case of New York City, whose residents account for disproportionately large shares of the nation's most affluent tax filers and of the total federal income taxes paid by U.S. households. Due to the high concentration of high-income households in the city, changes in the marginal rates of the top tax brackets would have a particularly large impact on city taxpayers. So would changes in preferential tax rates on capital gains income, the vast majority of which is received by taxpayers with the highest incomes. Any limits to the amount of itemized deductions taxpayers are allowed to claim would also have a big impact on New Yorkers because many city residents now itemize state and local tax liabilities, which are among the highest in the country. Top-bracket marginal rates, preferential capital gains rates, and limits to itemized deductions are all among the most contentious issues in the current tax policy deliberations.

This fiscal brief examines projected 2013 federal income tax liabilities of New York City residents in different income levels under five possible scenarios for federal income tax policy. In addition to the two basic (and divergent) possibilities—allowing all the tax cuts to expire and renewing all the tax cuts—IBO also models three scenarios for partial extension of the cuts. The aim is to estimate and compare possible impacts on the total and average federal income taxes of city residents by income level and to understand how the shares of total tax liability among different income groups would be affected. (In this brief, references to the "federal income tax" or simply the "income tax" refer to the federal individual income tax, as opposed to the federal *corporate* income tax, the federal payroll tax, or the federal estate tax.)

Major Tax Cuts Scheduled to Expire

The most far-reaching of the federal income tax cuts now scheduled to expire absent legislative action include:

- *Lower Marginal Tax Rates on Ordinary Income*. The six income tax brackets currently in effect, with marginal rates ranging from 10.0 percent to 35.0 percent, will revert to the pre-2001 schedule of five brackets with rates ranging from 15.0 percent to 39.6 percent.
- *Reforms to Address Marriage Penalties.* These include increasing both the standard deduction and the income range of the two lowest tax brackets for married couples filing jointly to twice those for single filers. Without renewal, the standard deduction and the two bottom brackets will revert to being only two-thirds larger than those for single filers in 2013.
- *Lower Capital Gains Tax Rates and Their Extension to Dividend Income.* Absent legislative action, the current tax rates on long-term capital gains of 0.0 percent for filers in the two lowest tax brackets and 15.0 percent for everyone else will revert to the previous preferential rates of 10.0 percent and 20.0 percent in 2013. Dividend income, which has also been taxed at preferential rates of 0.0 percent and 15.0 percent, will again be taxed as ordinary income.
- *Elimination of Limits to Deductions and Personal Exemptions.* Unless the current law is extended beyond 2012, a phased in limit to itemized deductions and a phased in elimination of personal exemptions for filers above certain income thresholds will again be in effect.
- *Enhanced Income Tax Credits.* These include doubling the child tax credit and increasing its refundability, boosting the earned income tax credit for married couples and filers with more than two children, and increasing the amount of child and dependent care expenses that can be claimed as a credit. These increases are set to expire in 2012.[1]

Data and Methodology

The Office of Tax Policy Analysis (OTPA) of the New York State Department of Taxation and Finance shares its annual sample of New York personal income tax returns with tax policy and revenue forecasting organizations, including IBO. Information that would permit identification of specific taxpayers is excluded from the sample. The most recent sample consists of almost 728,000 returns for tax year 2010. From the entire sample of state tax returns we have selected only the returns of full-year New York City residents, and we have excluded those filers claimed as dependents on another's tax return, such as children with their own taxable income.

The amounts of different types of income, deductions, and many credits reported on New York returns are taken directly from their federal returns, enabling us to replicate the most important components of New York City residents' 2010 federal tax returns. Using IBO's simulation model and our latest forecasts of income growth, interest rate changes, and other economic variables, we project how the different components of income reported in 2010 will look in 2013. Because the sample includes every 2010 state return of filers with incomes of $1.0 million or more, it is particularly valuable for accurately projecting the tax liabilities of these high-income New Yorkers, who account for a very large share of personal income in the city and of the tax liability of city residents. For other returns in the sample, OTPA uses known details about all returns filed in 2010—the population—to assign a weight to each sampled return that indicates how representative it is of the population as a whole.

Our projections for 2013 incorporate revenue from a new 3.8 percent federal income tax, established under the 2010 Affordable Care Act, on a portion of unearned income—such as capital gains and interest payments—received by taxpayers with incomes above certain thresholds. IBO estimates that the tax will be paid by an estimated 126,000 city residents under all scenarios modeled. Over 90 percent of the tax will be paid by taxpayers with seven-figure incomes. However, the projections do not incorporate the potential impact of another federal tax cut scheduled to expire at the end of the year, a 2 percentage-point reduction in the payroll tax. Payroll taxes paid by city residents are not reported on the income tax returns and thus cannot be estimated from the sample.

A Key Assumption. IBO's projections of 2013 income and tax liability under each of the five projections all assume that federal lawmakers will have renewed temporary increases in alternative minimum tax (AMT) exemptions used to determine potential AMT liability. Called the AMT "patch," these increases have been enacted without controversy for one or two years at a time since 2001 in order to prevent the AMT, which is not indexed for inflation, from adding to the tax liability of taxpayers at lower incomes. As of mid-December AMT patches for 2012 and 2013 have not yet been enacted. IBO estimates that failure to renew the AMT patch for 2012 would subject an additional 600,000 New York City taxpayers to the AMT—almost half would have incomes below $100,000. (For more information on the AMT, see IBO's April 2005 report, *The Alternative Minimum Tax Takes a Rising Toll on the City.*)

The Impact on New Yorkers' Income Taxes Under Different Scenarios

IBO's projections of the incomes and tax liabilities of city residents are based on the annual sample of New York personal income tax returns compiled by the New York State Department of Taxation and Finance. Before turning

Almost a Third of Income Received by Less Than 1 Percent of Filers, 2013

Income	Number of Filers		Federal AGI ($ millions)	
Under $0	33,453	0.9%	($7,541.7)	-2.6%
$0 to $20,000	1,133,174	32.0%	11,052.2	3.8%
$20,000 to $50,000	1,030,495	29.1%	34,175.2	11.6%
$50,000 to $75,000	496,592	14.0%	30,335.8	10.3%
$75,000 to $100,000	291,011	8.2%	25,188.4	8.5%
$100,000 to $150,000	264,494	7.5%	31,984.3	10.9%
$150,000 to $250,000	163,748	4.6%	30,845.0	10.5%
$250,000 to $500,000	77,280	2.2%	26,101.9	8.9%
$500,000 to $1,000,000	27,221	0.8%	18,658.6	6.3%
$1,000,000 to $2,000,000	12,262	0.3%	16,899.6	5.7%
Over $2,000,000	9,735	0.3%	76,992.3	26.1%
TOTAL	**3,539,465**	**100.0%**	**$294,691.7**	**100.0%**

SOURCES: IBO projections, based on 2010 PIT Sample File, Office of Tax Policy Analysis, New York State Department of Taxation and Finance
NOTE: AGI = Adjusted Gross Income. Figures may not sum due to rounding.

to discuss the five scenarios, it is useful to look at the income distribution of New York City's tax filers. Dividing the sample of city returns into groups based on each tax filer's 2013 projected federal adjusted gross income (AGI) shows the striking concentration of income among the city's most affluent tax filers. The approximately 49,200 filers who are projected to earn $500,000 or more in 2013—1.4 percent of a total of the city's estimated 3,539,500 filers—will receive 38.2 percent of all AGI reported on tax returns.[2] Over three-fifths—62.1 percent—are expected to have annual incomes under $50,000 and account for 12.8 percent of all income.

Full Renewal v. Full Expiration of Tax Cuts. If none of the federal income tax cuts about to expire are extended, federal income tax liability of New York City residents would total $59.1 billion in 2013 (Scenario 2), compared with $49.6 billion if all the cuts are renewed (Scenario 1). The difference between the two options is $9.5 billion, or 19.1 percent of total tax liability under the full-renewal scenario.

Full expiration would result in higher tax burdens for most taxpayers. The end of the 10-percent tax bracket and the reduced value of the various credits would have a significant impact on low- and moderate-income filers earning $75,000 or less. The additional tax liability of this group would be $2.2 billion, almost a quarter of the total new revenue from city tax filers. The average income tax liability of filers with incomes from $20,000 to $50,000 would nearly triple, from $583 to $1,685. Half of the additional revenue under the full expiration scenario would come from filers earning $500,000 or more, driven by higher marginal rates on ordinary income, higher rates on capital gains, and the re-instatement of limits on deductions.

The remainder of higher tax liabilities under the full expiration scenario—$2.5 billion—would be borne by a broad group of filers with incomes from $75,000 to $500,000. For these filers the interaction between the regular income tax and the AMT determines whether, and how much more, a taxpayer would pay if the tax cuts are not extended. Taxpayers in this income range account for 4 out of 5 of the 154,000 city taxpayers that would pay the AMT if all tax cuts are renewed—taxpayers whose AMT liabilities exceed their regular income tax liability and thus have not been receiving the full benefit of cuts to the regular income tax. IBO projects that 107,200 of those filers who would pay the AMT rather than the regular income tax under Scenario 1 (full extension) would switch to the regular income tax under Scenario 2 because their AMT liability—which does not change between Scenario 1 and Scenario 2—would now be lower than their regular tax liability. IBO estimates that of current AMT filers who would be switched to the regular income tax under full expiration, 83.8 percent are in the $75,000 to $500,000 range. For those who switch from one tax to the other, the liability increase under Scenario 2 is smaller than for others with similar income but who were never subject to the AMT.

Full Renewal v. Full Expiration of Tax Cuts, Federal Income Tax Liability, 2013

Income	Scenario 1 Full Renewal of Tax Cuts Liability *($ millions)*	Scenario 2 Full Expiration of Tax Cuts Liability *($ millions)*	Difference Scenario 2 Minus Scenario 1 Liability *($ millions)*	Share
Under $0	($11.2)	($5.4)	$5.9	0.1%
$0 to $20,000	(1,399.9)	(954.1)	445.8	4.7%
$20,000 to $50,000	601.2	1,736.5	1,135.3	12.0%
$50,000 to $75,000	2,767.3	3,389.3	622.0	6.6%
$75,000 to $100,000	2,938.8	3,474.3	535.4	5.7%
$100,000 to $150,000	4,396.3	5,186.5	790.2	8.4%
$150,000 to $250,000	5,312.2	6,029.5	717.2	7.6%
$250,000 to $500,000	5,981.7	6,459.7	477.9	5.1%
$500,000 to $1,000,000	4,886.9	5,234.4	347.6	3.7%
$1,000,000 to $2,000,000	4,846.2	5,442.0	595.8	6.3%
Over $2,000,000	19,323.5	23,109.6	3,786.1	40.0%
TOTAL	**$49,642.8**	**$59,102.1**	**$9,459.3**	**100.0%**

SOURCES: IBO projections, based on 2010 PIT Sample File, Office of Tax Policy Analysis, New York State Department of Taxation and Finance
NOTES: Both projections incorporate proposed increases in alternative minimum tax exemptions. Negative liability amounts indicate that the sum of refundable credits received by the group's filers exceed the sum of pre-credit liabilities. Figures may not sum due to rounding.

Three Options for Partial Renewal of Tax Cuts. Any agreement on federal income taxes is likely to feature renewal of only some of the soon-to-expire tax cuts, and even those which are renewed may be altered. Among the many possibilities, IBO has modeled three additional scenarios—Scenarios 3, 4, and 5—that vary in terms of limits on itemized deductions, preferential rates on realized capital gains, and tax rates on ordinary income. These three hardly exhaust the possible combinations of changes that are being considered, nor is any one of them likely to turn out to be the precise configuration of an agreement. However, they can be used to compare the impact on the distribution of tax liability that result from altering different aspects of the income tax. All options include renewal of some tax cuts that have stirred relatively little controversy—those addressing marriage penalties, the enhancement of credits largely received by low- and moderate-income tax filers, and increased AMT exemptions.

Scenario 3 renews all of the tax cuts except the elimination of limits to itemized deductions. In lieu of either no limits on deductions (in effect for 2012) or the disallowance of some deductions (in effect prior to 2006) the option includes a $50,000 cap on itemized deductions for filers with incomes over certain thresholds: $250,000 AGI for joint filers, $125,000 for married persons filing single, and $200,000 for all other filers. The cap would be phased in over a $50,000 interval beginning at these thresholds.[3]

Three Scenarios for Partial Renewal of Tax Cuts
Total Federal Income Tax Liability, 2013

Income	Scenario 3 Cap Itemized Deductions ($ millions)	Scenario 4 Restore Former Capital Gains Tax Rate ($ millions)	Scenario 5 Eliminate Tax Cuts for Incomes Over $250,000 ($ millions)
Under $0	($11.2)	($11.2)	($11.2)
$0 to $20,000	(1,399.9)	(1,397.1)	(1,399.9)
$20,000 to $50,000	601.2	629.1	601.2
$50,000 to $75,000	2,767.3	2,797.9	2,767.3
$75,000 to $100,000	2,938.8	2,969.0	2,938.8
$100,000 to $150,000	4,396.3	4,441.4	4,397.1
$150,000 to $250,000	5,316.8	5,365.6	5,321.1
$250,000 to $500,000	6,378.0	6,055.9	6,062.1
$500,000 to $1,000,000	5,424.4	4,978.0	5,132.8
$1,000,000 to $2,000,000	5,265.5	4,970.5	5,360.8
Over $2,000,000	23,306.3	20,781.8	22,250.9
TOTAL	**$54,983.5**	**$51,580.9**	**$53,420.9**

SOURCES: IBO projections, based on 2010 PIT Sample File, Office of Tax Policy Analysis, New York State Department of Taxation and Finance
NOTES: All projections incorporate proposed increases in alternative minimum tax exemptions. Negative liability amounts indicate the sum of refundable credits received by the group's filers exceed the sum of pre-credit liabilities. Figures may not sum due to rounding.

Scenario 4 extends all the tax cuts with a different exception: the preferential rates on long-term capital gains income and dividends would not be extended. Capital gains rates would revert to their former preferential levels: 10.0 percent for filers whose incomes put them in the lowest two tax brackets and 20.0 percent for others. Dividend income would again be taxed at the regular rates covering wages and other forms of ordinary income.

Scenario 5 includes a renewal of the tax cuts but limits most of the benefits to filers with AGIs under $200,000 to $250,000, depending on filing status. Cuts to marginal tax rates on ordinary income would remain in place for these filers, but filers with higher incomes would be subject to the top marginal rates of 36.0 percent and 39.6 percent in effect before 2001.[4] The option maintains the elimination of itemized deduction limits for filers with AGIs under $200,000 to $250,000, but it once again disallows a share of itemized deductions for those with higher incomes. It also renews the lower preferential tax rates on capital gains and qualified dividends for all filers except those in the top two tax brackets, which would be subject to a 20.0 percent preferential rate on both forms of income.[5]

Comparing Tax Liability Under Scenarios 3, 4, and 5. Total tax liability of city residents projected under these alternatives is (as expected) higher than it would be if all tax cuts were extended (Scenario 1) and lower than if all tax cuts were allowed to expire (Scenario 2). But total liability for filers over a broad range of incomes—those with AGIs of $50,000 to $250,000—varies little among these three alternatives; on average for the three scenarios, total liability is less than 0.4 percent higher than the taxes these filers would pay if all the tax cuts were extended. In contrast, total liability varies more substantially across scenarios for filers with AGIs less than $50,000 or greater than $250,000.

Among these three alternatives, total income taxes of New York City residents would be highest under Scenario 3, where itemized deductions for some taxpayers are strictly capped. But in comparison with the full extension option, the higher tax liabilities under Scenario 3 are almost entirely limited to taxpayers with AGIs above $250,000—the income at which all taxpayers of all filing statuses would be subject to the cap. The cap on itemized deductions would mean that many city residents would not be able to take full advantage of deductions for state and local taxes and mortgage interest—deductions which are particularly valuable to New Yorkers because of the heavy state and local tax burden and the large mortgages taken out to finance purchases in the city's high-cost market for real estate.[6] Among taxpayers with AGIs above $250,000 who itemize, the average and median of total itemized deductions prior to limits far exceeds the $50,000 cap. For example, IBO projects that for filers with AGIs from $250,000 to $500,000 who itemize, 2013 deductions will average $79,000 before limits; the median deduction for these filers is $69,000. Over half of the total deductions claimed by this group (51.1 percent) are deductions of state and local taxes, 28.8 percent are deductions of mortgage interest payments, and 12.1 percent are deductions of charitable contributions.[7]

The total income tax liability of city residents that would result from raising tax rates on capital gains income and taxing dividends as ordinary income while renewing all other tax cuts—Scenario 4—is $3.4 billion less than the total under Scenario 3. But Scenario 4 would have a broader impact than Scenario 3 because some filers at all levels of income receive income from dividends and/or capital gains. Income from dividends is concentrated among high-income filers but not nearly to the same extent as net realized capital gains (realized gains minus realized losses). For example, IBO projects that filers with incomes under $250,000 account for 25.0 percent of all dividend income, compared with only 4.4 percent of capital gains. Income from capital gains is particularly concentrated among a relatively small group of the city's very highest income taxpayers. The 9,700 filers with AGIs of $2.0 million or more are projected to receive 83.6 percent of all 2013 capital gains income, compared with their 55.2 percent share of dividend income.

Difference From Scenario 1 (Full Renewal)
Total Federal Income Tax Liability, 2013

Income	Scenario 2 Full Expiration of Tax Cuts *($ millions)*	Scenario 3 Cap Itemized Deductions *($ millions)*	Scenario 4 Restore Former Capital Gains Tax Rates *($ millions)*	Scenario 5 Eliminate Tax Cuts for Incomes Over $250,000 *($ millions)*
Under $0	$5.9	$-	$-	$-
$0 to $20,000	445.8	-	2.8	-
$20,000 to $50,000	1,135.3	-	27.9	-
$50,000 to $75,000	622.0	-	30.7	-
$75,000 to $100,000	535.4	-	30.2	-
$100,000 to $150,000	790.2	0.0	45.1	0.8
$150,000 to $250,000	717.2	4.6	53.4	8.9
$250,000 to $500,000	477.9	396.3	74.2	80.3
$500,000 to $1,000,000	347.6	537.5	91.1	245.9
$1,000,000 to $2,000,000	595.8	419.3	124.3	514.6
Over $2,000,000	3,786.1	3,982.9	1,458.3	2,927.5
TOTAL	**$9,459.3**	**$5,340.7**	**$1,938.1**	**$3,778.1**

SOURCES: IBO projections, based on 2010 PIT Sample File, Office of Tax Policy Analysis, New York State Department of Taxation and Finance
NOTE: All projections incorporate proposed increases in alternative minimum tax exemptions. Figures may not sum due to rounding.

With income from capital gains and (to a lesser extent) dividends concentrated at the top end of the income distribution, the impact of Scenario 4 is mostly borne by high-income filers. Those with incomes of $250,000 or more would account for 90.2 percent of the additional taxes under this scenario, compared with tax liability under Scenario 1 (all tax cuts extended). Most of these filers are in the highest tax bracket where the marginal rate on ordinary income would remain 35.0 percent under this alternative. For these taxpayers, the tax rate on dividends would more than double under this scenario, rising from 15.0 percent to 35.0 percent, compared with a smaller increase in the capital gains tax rate from 15.0 percent to 20.0 percent. Total dividends received by these filers are significant, equal to almost a third (29.3 percent) of total capital gains, so the combination of both increases result in very large increases in tax liability for many high-income filers.

If tax cuts were extended in full only for filers with AGIs below $250,000—Scenario 5—the impact would be limited to those with incomes above the threshold.[8] Total federal income tax liability of city residents under this alternative would be greater than under Scenario 4. High-income filers would pay more because in addition to facing higher tax rates on capital gains and dividends, they also face higher tax rates on their ordinary income, with the top rate reverting to 39.6 percent, an even steeper increase than under Scenario 4. Also adding to the liability of affected taxpayers would be the return of the full disallowance of a portion of itemized deductions that had been in effect until 2006.

But in general Scenario 5 does not add as much to the taxes of affected taxpayers as does Scenario 3, because the disallowance of a portion of itemized deductions that would come back into effect under Scenario 5 would have less of an impact on deductions than the $50,000 cap under Scenario 3. For example, under Scenario 5 a taxpayer with an AGI of $685,000 and a total of $155,000 in itemized deductions before limitations—the average values projected for filers with incomes from $500,000 to $1.0 million—would still be able to claim $140,000 in deductions, compared with $50,000 in deductions under Scenario 3.

Differences in Average Tax Liability. If all the tax cuts currently expiring are fully renewed (Scenario 1), IBO estimates that the average federal income tax liability of New York City residents will be $14,026 in 2013. If the tax cuts are allowed to expire (Scenario 2), taxes will average $16,699—$2,673 more than if the cuts were fully renewed. Not surprisingly, the difference in average taxes between the two options increases with increases in income, ranging from under $400 for the two groups for tax filers with AGIs under $20,000 to nearly $400,000 for filers with incomes above $2.0 million.

Average tax liability under the other scenarios in which not all tax cuts are renewed would also be greater than the average under full renewal—by $1,509 for Scenario 3, $548 for Scenario 4, and $1,067 for Scenario 5. But liability would not increase for filers in all income groups. Under Scenarios 3 and 5, average liability for virtually all filers with incomes under $150,000 would be no different than if all tax cuts were renewed. Under Scenario 4 liability would average $171 more than under full extension (Scenario 1) for taxpayers with incomes from $100,000 to $150,000 and by less for those with lower incomes.

For filers with incomes above $150,000, average tax liability is higher under the three scenarios for partial renewal of the tax cuts (Scenarios 3, 4, and 5) than under full renewal of the tax cuts (Scenario 1). Conversely, average liability under the three alternatives for partial renewal are lower than average liability under Scenario 2 where all tax cuts are allowed to expire—with one notable exception. Among all the scenarios, average taxes for filers with incomes over $2.0 million would be highest with a $50,000 cap of itemized deductions—$2,394,077 under Scenario 3—compared with $2,373,864 under Scenario 2 (full expiration) and $1,984,948 under Scenario 1 (full extension).

Capping deductions at any amount that affects more than a just a handful of taxpayers would greatly boost the amount of income subject to taxation and therefore the liability of high-income taxpayers, particularly those with the very highest incomes. Over one-third (34.5 percent)

Average Federal Income Tax Liability Compared With Full Renewal of Tax Cuts (Scenario 1), 2013

Income	Average Tax Scenario 1: Full Renewal of Tax Cuts	Average Tax Difference From Scenario 1: Scenario 2: Full Expiration of Tax Cuts	Scenario 3: Cap Itemized Deductions	Scenario 4: Restore Former Capital Gains Tax Rates	Scenario 5: Eliminate Tax Cuts for Incomes Over $250,000
Under $0	($336)	$176	$-	$-	$-
$0 to $20,000	(1,235)	393	-	3	-
$20,000 to $50,000	583	1,102	-	27	-
$50,000 to $75,000	5,572	1,253	-	62	-
$75,000 to $100,000	10,099	1,840	-	104	-
$100,000 to $150,000	16,622	2,988	-	171	3
$150,000 to $250,000	32,441	4,380	28	326	55
$250,000 to $500,000	77,403	6,185	5,128	960	1,040
$500,000 to $1,000,000	179,526	12,768	19,747	3,347	9,033
$1,000,000 to $2,000,000	395,218	48,590	34,198	10,141	41,967
Over $2,000,000	1,984,948	388,916	409,129	149,798	300,717
TOTAL	**$14,026**	**$2,673**	**$1,509**	**$548**	**$1,067**

SOURCES: IBO projections, based on 2010 PIT Sample File, Office of Tax Policy Analysis, New York State Department of Taxation and Finance
NOTE: All projections incorporate proposed increases in alternative minimum tax exemptions.

of total itemized deductions (before limits) are taken by taxpayers with incomes over $2.0 million, and their average deduction—$2.6 million—is nearly eight times as large as the average for taxpayers with AGIs from $1.0 million to $2.0 million. Taxpayers with AGIs above $2.0 million account disproportionately for large shares of the two biggest deduction items—39.7 percent of all filers' deductions of state and local taxes and 63.0 percent of all deductions for charitable contributions. However, they account for only 10.0 percent of mortgage interest deductions, the third largest deduction item.[9]

Shares of Total Federal Taxes of City Residents. Compared with full extension of the tax cuts, the share of total federal taxes paid by filers with annual incomes below $50,000 would be greater if all tax cuts expire (Scenario 2). The relative benefit of the 10 percent tax bracket is greatest for these filers—a benefit they would no longer have under Scenario 2. Full expiration would also reduce the value of the credits that are designed to provide the greatest benefit to residents with incomes under $50,000.

Filers with incomes from $250,000 to $2.0 million would bear a smaller proportion of total income tax liability if none of the tax cuts were renewed (Scenario 2), compared with full extension (Scenario 1). These filers would be less affected by increases in capital gains tax rates than would those with the highest incomes. In addition, many of these filers would benefit from no longer being subject to the AMT as would many filers in the $150,000 to $250,000 income group.[10] The top income group's share of total federal taxes paid by city residents differs little under the full extension or full expiration scenarios—close to 39.0 percent under each of these alternatives.

Among the three scenarios with partial renewal of the tax cuts there are small differences in the shares of total taxes borne by New Yorkers at different income levels. Compared with full renewal of the tax cuts (Scenario 1), these three alternatives would each reduce to varying degrees the share of total taxes borne by filers with incomes between $20,000 and $150,000 because each of these scenarios result in higher taxes primarily for filers with higher incomes. The share of total liability borne by filers between $20,000 and $150,000 is highest under Scenario 4, which increases taxes on all capital gains and dividend income, including taxes for filers in these income ranges.

Scenario 3 results in generally smaller shares of the total tax burden on those with lower incomes than does either Scenario 4 or Scenario 5 because the effect of capping itemized deductions greatly increases both tax liability and

Distribution of Total Federal Income Tax Liability, 2013

Income	Scenario 1 Full Renewal of Tax Cuts	Scenario 2 Full Expiration of Tax Cuts	Scenario 3 Cap Itemized Deductions	Scenario 4 Restore Former Capital Gains Tax Rates	Scenario 5 Eliminate Tax Cuts for Incomes Over $250,000
Under $0	0.0%	0.0%	0.0%	0.0%	0.0%
$0 to $20,000	-2.8%	-1.6%	-2.5%	-2.7%	-2.6%
$20,000 to $50,000	1.2%	2.9%	1.1%	1.2%	1.1%
$50,000 to $75,000	5.6%	5.7%	5.0%	5.4%	5.2%
$75,000 to $100,000	5.9%	5.9%	5.3%	5.8%	5.5%
$100,000 to $150,000	8.9%	8.8%	8.0%	8.6%	8.2%
$150,000 to $250,000	10.7%	10.2%	9.7%	10.4%	10.0%
$250,000 to $500,000	12.0%	10.9%	11.6%	11.7%	11.3%
$500,000 to $1,000,000	9.8%	8.9%	9.9%	9.7%	9.6%
$1,000,000 to $2,000,000	9.8%	9.2%	9.6%	9.6%	10.0%
Over $2,000,000	38.9%	39.1%	42.4%	40.3%	41.7%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

SOURCES: IBO projections, based on 2010 PIT Sample File, Office of Tax Policy Analysis, New York State Department of Taxation and Finance
NOTE: All projections incorporate proposed increases in alternative minimum tax exemptions. Figures may not sum due to rounding.

the share of total tax liability borne by taxpayers at the very top of the income distribution. Taxpayers with AGIs above $2.0 million would bear 42.4 percent of the total federal tax burden on all city residents under Scenario 3, compared with 38.9 percent if all tax cuts were extended and 40.3 percent and 41.7 percent under Scenarios 4 and 5, respectively.

Conclusion

The outcome of the current negotiations in Washington over the fate of the many tax cuts set to expire on December 31, 2012 could produce large federal income tax liability changes for New York City residents. If all of the cuts were allowed to expire, city filers would owe the federal government $9.5 billion (19.1 percent) more in income taxes in 2013 than if all of the changes were extended. While high-income taxpayers would bear much of this increase, the impact in percentage terms would be greatest at the lower end of the income scale.

Under the scenario closest to the plan introduced by President Obama in his federal budget proposal, which allows the tax cuts to expire for filers with incomes over $200,000 for singles and $250,000 for couples, city tax filers would pay $3.8 billion (7.6 percent) more than if all changes were extended. This scenario would result in filers with incomes over $250,000—3.6 percent of all New York City resident filers—increasing their share of federal income taxes paid to 72.6 percent, up from 70.5 percent under full renewal of the tax cuts.

Of the scenarios considered, the one that yielded the most tax revenue, apart from full expiration of the tax cuts, extends all the tax cuts but adds a cap of $50,000 on itemized deductions for filers with incomes above $200,000 or $250,000, depending on filing status. Given New York's high state and local tax burdens, the significance of the deduction for state and local taxes, combined with the extraordinary concentration of deductions for charitable contributions among taxpayers with very high incomes means this scenario would generate $5.3 billion (10.8 percent) more revenue than simply extending all of the current tax cuts. This result would likely be different elsewhere in the country where state and local taxes are generally lower.

While an outcome in Washington that limited the use of itemized deductions would likely generate a particularly large share of new revenue from New York taxpayers, New York's disproportionate share of high-income returns makes it likely that city taxpayers would contribute a large share of the additional federal tax revenue under any scenario other than extending all of the tax cuts.

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Endnotes

[1]More specific information on expiring tax cuts, including cuts to other taxes such as the estate tax and the payroll tax, can be found on the Web site of the Tax Policy Center, a joint project of the Urban Institute and Brookings Institution.
[2]This percentage is based on a total that includes the negative income of approximately 33,500 filers. If negative incomes are excluded from the calculations, the percent shares of AGI received by the over-$500,000 group and the under-$50,000 group become slightly lower—37.2 percent and 11.6 percent, respectively.
[3]For example, in the case of a single filer, the share of deductions allowed over $50,000 would gradually decline from 100.0 percent for filers with up to $200,000 to 0.0 percent for filers with incomes of $250,000 or more.
[4]We've used the specific tax-bracket ranges and rates employed by the Tax Policy Center in their modeling of President Obama's proposal for the federal fiscal year 2013 budget.
[5]Unlike Scenario 4, Scenario 5 does not tax any filer's dividends as ordinary income, as was done before the 2003 tax cuts.
[6]These deductions, however, are not available to those taxpayers subject to AMT liability.
[7]For taxpayers with higher incomes, mortgage interest accounts for a smaller share of total deductions while the shares of deductions for charitable contributions and (in most cases) state and local taxes are larger.
[8]This threshold applies to married couples filing jointly; the thresholds for single and head of household filers are lower.
[9]Deductions of state and local taxes by all filers account for 44.2 percent of total deductions before limits, deductions of charitable contributions account for 21.2 percent of total deductions, and deductions for interest payments account for 20.3 percent.
[10]IBO estimates that 7 out of 10 of the 107,200 taxpayers who would no longer pay the AMT if the tax cuts were not extended would have AGIs from $150,000 to $500,000.

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